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Edited by R.J. Barry Jones

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G

Galbraith, John Kenneth (1908–)

By any standard, John Kenneth Galbraith has had a unique career, combining academic work, public service and popular writing. After receiving his Ph.D. from the University of California, Berkeley, with further work at Cambridge University, his teaching positions included Harvard (since 1949) and Princeton Universities. Other endeavours included: National Defense Advisory Commission; Deputy Administrator, US Office of Price Administration; Editor, *Fortune* magazine (1943–8); Director of the Strategic Bombing Survey (1946); Director of the Office of Economic Security (1946), and American Ambassador to India (1961–3). Although he has published numerous articles in the professional journals, Galbraith is best known for his widely read books. Often writing in the tradition and style of THORSTEIN VEBLEN, his studies introduce highly original insights on consumers' countervailing power to large oligopolies (see OLIGOPOLY), on the contrast between private affluence and public squalor, and on the managerial nature of modern capitalism.

Bucking the trend towards 'positive economics' ('what is' economics), Galbraith has carried on in the tradition of 'normative economics' ('what should be' economics). His main integrating theme is that industrial societies and, in particular, American industrial society, no longer resemble the descriptive model of conventional economic theory, namely the competitive market model of profit-maximizing firms and utility-maximizing sovereign consumers. As a consequence of this development, the capitalist economic system now produces an excess of waste and a multitude of undesirable products (see CAPITALISM).

This theme was best developed in *The Affluent Society* (1955), in which Galbraith argues that it is no longer appropriate for affluent societies to place a priority on economic growth and maximization of output. Over-emphasis on production for private consumption leads to too little spending on public goods/services and too little leisure and economic security, among other undesirable consequences. Galbraith considers it obvious that increasing affluence constantly threatens to make the further growth of private consumption less urgent. Something unnatural has to happen, therefore, to keep people spending. This is where ADVERTISING comes in, creating demand for new products as part of the process of production. In other words, consumer sovereignty has been effectively replaced by producer sovereignty. At the same time, vital public services (roads, schools, museums, low-cost housing, the police and so on) increasingly demanded by a rich society are starved of revenue because of the belief that progressive taxation destroys economic incentives. The result is a society which mixes affluence in the private sphere with squalor in the public sphere.

The New Industrial State (1967) summarizes much of Galbraith's thought on the giant firms. Such a predominance of large-scale enterprises is the result of the complicated nature of modern technology. The separation of ownership from control has meant that decision-making is undertaken by an overlapping bureaucracy of experts or what he refers to as the 'technostructure'. Such a structure no longer has profit-maximizing as its aim, but rather survival, security and the elimination of risk.

While Galbraith's views have received wide praise and government support outside the

economic profession, they have been less well received by academic economists. Clearly, his liberal views were at odds with the ascendancy of SUPPLY-SIDE ECONOMICS in the late 1970s. At a seminar in Berkeley in the late 1990s, Galbraith was asked: 'What would you like, in your work, to be most remembered for?' His answer was:

I suppose that I would, in economics, most like to be remembered – and most plausibly will be remembered – for bringing emphasis to an economic structure in which the characteristic organization is the great corporation rather than the competitive enterprise, and of seeing economic life as a bipolar phenomenon, by which I mean, seeing it as a structure, on the one hand, of a few hundred great corporations, and seeing it, on the other hand, as the residual structure of agriculture, small business, the services. And arguing that the controlling economic behavior in the two parts is by no means the same. It has to be examined separately.

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many of Galbraith's ideas on industry, government and American society.

ROBERT LOONEY

Galtung, Johan (1930–)

Johan Galtung is one of the founders of modern peace studies. He established the International Peace Research Institute (PRIO), Oslo, in 1959 and the *Journal of Peace Research* in 1964. He has been professor and visiting professor in the United States, Latin America, Europe, Africa and Asia. The author of more than fifty books, his most recent appointment has been as Professor of Peace Studies at the University of Hawaii.

His writings are challenging and thought provoking. Erudite and almost encyclopedic in approach, his work reflects a systematic effort to deal with major issues of peace and development, IMPERIALISM and centre-periphery relations, and conflict transformation and the economics of self-reliance. Born in Norway, but very much 'a citizen of the world', key strands of his thought relate to the need to get beyond the arrogance of Western-centrism and narrow assumptions about one true world of development/modernization. He attaches considerable significance to the value of enlarging our visions and understandings through dialogues with various civilizations and traditions.

To political scientists and economic historians, Galtung is perhaps best known for his theories of structural violence and imperialism. The first of these theories distinguishes between direct and indirect forms of violence. In making this distinction, Galtung tried to liberate himself from the actor-orientated perspective of so much Western social science. Structural violence is seen not so much as intentional harm but as taken-for-granted processes built into exploitative or discriminatory structures. Such processes usually work slowly rather than quickly, as with the misery of poverty and hunger, to damage and cut short the lives of those adversely affected. In

his theory of imperialism, this reconceptualization of violence is extended to centre-periphery relations in a world system.

When first published in 1971, Galtung's essay 'A structural theory of imperialism' (see Galtung 1980) aroused considerable interest. This was partly due to timing, but it was also because it critiqued both capitalist and communist variants of imperialism. In using such words as *EXPLOITATION*, penetration, segmentation, fragmentation and marginalization to deconstruct the workings of imperialism, Galtung made it clear that these are shorthand formulations. They concern complex and often destructive economic, social and political relations, embedded in structural gradients of privilege and power.

To add to this multifaceted picture, distinctions are drawn by Galtung between six overlapping aspects of imperialism. These are distinguished according to the content of the division of labour between centre and periphery countries: economic, political, communicative, cultural and social. Phases of imperialism are broadly mapped as 'COLONIALISM', 'NEO-COLONIALISM' and 'neo-neocolonialism'.

Together with a strongly eclectic interest in learning from both Western and non-Western knowledge and traditions, Galtung is an incisive and controversial critic of narrow or dogmatic disciplinary pursuits and of mind-sets that edit out alternatives. A prime culprit in this respect, he suggests, is conventional economic theorizing. It prizes itself on its *RATIONALITY* and scientific credibility but, he concludes, generally fails to critically scrutinize its basic assumptions.

He adds that to understand patterns of direct and structural violence, it is important to illuminate how various forms of cultural violence mediate and rationalize the 'normality' or 'inevitability' of centre-periphery relations, human rights violations, gendered violence, impoverishment and environmental destruction. Conventional economic theorizing, he charges, fails to adequately diagnose such social and economic ills. Its prognoses also often fail to illuminate issues satisfactorily, and he contends that its therapies, including

INTERNATIONAL MONETARY FUND (IMF)-prescribed medicines for low-income economies, frequently have very different effects from the proclaimed goals of 'economic recovery' or progress.

Genealogically speaking, he advances the argument that mainstream economics selectively interprets what has been, bolsters what is and impoverishes alternative thinking about what might be:

Imagine now a world where economic growth in the modern sense of that word, well operationalized in GNP/capita, gets started ... An enormous amount of violence accompanies the phenomenon, such as slavery and the triangular trade, colonialism ... and ... the repression of the working class ...

What is missing is the good conscience ... the firm conviction of being on the right and righteous path even if there is more suffering on the way ... Mainstream economics produced and reproduced that justification, as a coherent, brilliant exemplar of cultural violence ...

(1996b: 133)

Along with others who have been active in The Other Economic Summit (TOES) movement, he is not iconoclastic for the sake of it. He wants a thorough rethinking of 'economics'. While he concedes that 'a new economics' will be difficult to achieve, he argues that it is important to contribute to such a debate as part of a wider discourse on social alternatives in the twenty-first century. By so doing, a start may be made in rethinking economics in ways that display a greater humility about truth claims and a lesser propensity for a violent, gendered and orientalist gaze. The shadow areas of conventional economic abstractions and 'EXTERNALITIES' may become, he further argues, better lit, so that the poor, women, the natural environment and the needs of future generations are no longer so largely neglected.

See also:

Gandhi, Mohandas Karamchand; imperialism; structural violence; war

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FRANCIS P. HUTCHINSON

game theory

Game theory is a FORMAL THEORY OF STRATEGIC INTERACTION used by some economists and political scientists. It provides a tool for the mathematical analysis of situations where all actors can influence the outcome and thus each must consider other's actions when deciding what to do. In contrast, market or GENERAL EQUILIBRIUM approaches assume that individuals make their choices without considering the choices of others. In economics, game theory has been used to study bargaining, industrial organization and STRATEGIC TRADE THEORY among other topics. In political science, it has been used to study COOPERA-

TION, COLLECTIVE ACTION in small groups, economic sanctions (see SANCTIONS, ECONOMIC), pressure groups, PUBLIC CHOICE (PC) THEORY and other topics outside international political economy (IPE).

Game theory falls into two branches, cooperative and non-cooperative. Cooperative game theory addresses how players agree to divide their possible gains. There are two main questions here: first, which group of players will coordinate their actions and, second, how will they divide the gains of that coordinated action? A variety of solution concepts strive to capture bargaining dynamics in cooperative game theory. Non-cooperative game theory analyses actors' incentives to honour their agreements. A non-cooperative game specifies who the actors are, what their choices are, the order of those choices, how the choices lead to outcomes, what the actors know when they have to choose and their values for the outcomes. Such games are solved by finding their equilibria. An equilibrium is a set of actions in the game where no actor can make itself better off by changing its action, assuming that all actors correctly anticipate what each other will do.

Games fall into the classes of zero-sum and non-zero-sum (see ZERO-SUM GAMES). The latter are of greater interest in IPE because they do not require that the gains of one player be matched by the losses of another. PRISONERS' DILEMMA, the best-known game, is non-zero-sum.

Games are abstractions of social situations. Such abstractions may be useful in stripping away the complexity of a situation so that its basic principles can be analysed. For example, prisoners' dilemma illustrates how individual incentives can lead to a situation where all are worse off. Game theory, then, is not a theory of IPE; it is a tool for the explication of theories of IPE.

For example, bargaining is commonly modelled using game theory. Real cases of bargaining are very complex. The parties have idiosyncratic political and economic motivations in most cases, the subject of negotiations may have unusual characteristics that make

striking a bargain difficult and the parties may have a history that influences how they bargain with each other. Most bargaining games strip away all this complexity in favour of focusing on a few strategic issues. These models typically have two parties bargain over a fixed cake with a given sequence of offers and responses. The roles of impatience for a settlement, values attached to the share of the cake received and knowledge of the other side's value for the cake can all be analysed in these games. These bargaining games highlight strategic dynamics that may be obscured in the complexity of an actual negotiation. General principles deduced from such a model can then be applied to understand actual cases.

The application of game theory to IPE has been criticized. Some claim that it cannot model theories of social structure because it is based on methodological individualism (see INDIVIDUALISM, METHODOLOGICAL), that is, it analyses the choices of individuals apart from their social context. However, a game does specify the social setting under which those individual choices are made. Others argue that game theory cannot model theories such as STRUCTURATION because they claim that games assume the interests and identities of the players – a central question in such theories. Those who use game theory respond that there are games where interests and identities are not fixed by the rules of the game. Much of the problem here lies in the lack of clear identification between the primitive concepts of game theory and concepts from structuration like identities and interests.

Game theory as a tool has produced some important results for IPE, particularly in economics. It is not, however, a central methodology in the field.

See also:

formal theory; rational choice; strategic interaction

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JAMES D. MORROW

Gandhi, Mohandas Karamchand (1869–1948)

Gandhi is the twentieth century's leading theoretician and practitioner of non-violence. Born in Gujarat, India, he trained as a lawyer in Britain before taking up practice in South Africa. His experience of racism in South Africa radicalized him, but he chose to fight discrimination and oppression non-violently in South Africa and through the independence movement in India.

The principles of active non-violent resistance (*satyagraha*) were core elements of Gandhi's thinking relating to economy, politics and the future of Western and non-Western civilization. In his critiques of the Western idea of progress, he questioned the cultural violence implicit in the assumption of one true world of technological and economic development:

Wisdom is no monopoly of one continent or race. My resistance to Western civilization is really a resistance to its indiscriminate and thoughtless imitation based on the assumptions that Asiatics are fit only to copy everything that comes from the West ...

(*Young India*, 4 August 1927; quoted in Fisher, 1961: 290)

If seen as a saint or *mahatma* by many for his principled stand on difficult political issues, Gandhi was also regarded by many as 'un-worldly' in his critique of the Western idea of progress. Portrayed as a kind of latter-day Luddite, his views on Western technology and development received much bad press even from some of his most sympathetic admirers.

GDP deflator

However, especially over the last decade, there have been various attempts to reappraise his ideas for alternative models of development (*sarvodaya*). Within post-colonial theory, eco-feminist theory and peace theory the writings of Vandana Shiva, Nandini Joshi, Ashis Nandy, Claude Alvares, Leela Gandhi and JOHAN GALTUNG exemplify this trend.

See also:

colonialism; globalization; modernization theory; racism; structural violence

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FRANCIS P. HUTCHINSON

GDP deflator

Nominal GROSS DOMESTIC PRODUCT (GDP) is the money value of total output and is valued at current prices. A change in nominal GDP reflects both changes in quantities and changes in prices. Real GDP is total output valued at the prices of a fixed base year. Changes in real GDP reflect only changes in the quantity of output.

The GDP deflator is defined as:

$$\frac{\text{GDP at current prices (nominal GDP)}}{\times 100 \text{ GDP at base year prices (real GDP)}}$$

If the GDP deflator is 1 per cent higher than last year, it costs 1 per cent more to produce the

same goods and services that were produced last year.

M. PETER VAN DER HOEK

gender

The term 'gender' refers to a set of socially constructed characteristics associated with masculinity and femininity: when feminists (see FEMINISM) use the term they are generally not referring to biological differences between women and men. Most feminist theorists, outside the liberal school, claim that what it means to be a man or a woman varies across cultures and history. In the contemporary West, the terms 'strong', 'autonomous', 'rational' and 'public' are typically associated with masculinity, while their opposites ('weak', 'dependent', 'emotional' and 'private') are associated with femininity. Importantly, these are relational terms which signify unequal power relationships. Since characteristics associated with masculinity are assigned greater value in all societies, gender relations legitimate a set of unequal social relationships which can perpetuate and naturalize women's oppression. Feminists also emphasize difference within gender categories such as class, race and ethnicity, which denote further relationships of inequality.

Feminists are introducing gender analysis into the field of international political economy (IPE) to explain why women are under-represented in positions of political and economic power in most states and why the WORLD ECONOMY differentially affects and rewards women and men. They draw on data, disaggregated by sex, which are exposing systematic political, social and economic inequalities between women and men on a global basis. Feminists claim that these persistent inequalities cannot be understood without including gender as a category of analysis. While IPE has focused on the behaviour of states and markets, gender analysis emphasizes the global gendered division of labour as an explanation for women's subordination.

Feminists claim that gender ideologies, as defined above, have the effect of assigning to women work that is unremunerated, such as the management of households, the care of children and subsistence agriculture. When women work in the labour force, they are disproportionately located in poorly paying jobs, such as service industries and the caring professions, which are typically defined as 'women's work'. Feminists believe that these gender ideologies naturalize this gendered division of labour, making it necessary to look beyond legal forms of discrimination and examine how deeply embedded patriarchal structures act to reinforce women's oppression.

Although outside the field of IPE as conventionally defined, there is a considerable literature on women and development which uses gender as a category of analysis. This literature demonstrates that the development process has often led to a deterioration of women's status relative to men's. Feminists claim that liberal strategies which advocate economic growth through market forces and integration into the global economy have a differential impact on women and men. The negative effects of STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) on women have been an important focus of this literature on women and development.

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ANN J. TICKNER

General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) was a treaty first signed in 1947 by the major free-market economies to promote the LIBERALIZATION of trade in the international economy and to oversee fair-play in international trade relations. The treaty resulted from a series of negotiations to create a new INTERNATIONAL TRADE ORGANIZATION (ITO) to oversee the liberalization and policing of trade relations, which also produced agreement on some preliminary TARIFF reductions among the negotiating countries. The direct result of the negotiations was the HAVANA CHARTER of 1948, which did indeed establish a new ITO. However, the US Congress refused to ratify the Havana Charter in 1950 and this, given the significance of the United States in the world economy and the international trading system, effectively destroyed the treaty and the new ITO. The pragmatic response to the crisis of the rejection by the United States of the Havana Treaty was the decision to use the GATT as the basis for future trade liberalization negotiations and to take over the ITO's Interim Committee and use it as the secretariat for the GATT. The GATT was also formally identified as a specialized agency of the UNITED NATIONS (UN).

The GATT proved to be a surprisingly effective organization given its unpromising start. It promoted the central principle of the MOST FAVOURED NATION, which required that the most generous treatment extended by any member-state to imports from any other state should be extended to all its trading partners. The membership of the GATT increased steadily as more economies recovered from the damage inflicted by World War II and as others secured freedom from colonial control. The twenty-three initial signatory states – or contracting parties – had risen to seventy-six by 1969, with a further eleven attending as observers. Accession to the treaty required new members to pay an 'entrance fee' in the form of new tariff concessions.

General Agreement on Tariffs and Trade (GATT)

The GATT was revised substantially for the first time in 1955, when an attempt was made to bring export SUBSIDIES under greater control, with new requirements for disclosure of such practices by the contracting parties. In 1965, a second major revision brought special provisions into play that permitted a weakening of the most-favoured-nation provision in trade arrangements with LESS-DEVELOPED COUNTRIES (LDCs).

Decision-making within the GATT was based on the principle of one member, one vote: a principle that progressively endowed the increasingly numerous LDCs with enhanced potential influence. However, a unanimous vote of all of the contracting parties was necessary for any change to the most basic of the treaty's articles: Articles I, II and XXX providing for, respectively, the most-favoured-nation principle of non-discrimination, the consolidation of past tariff negotiations and the prescription of the procedures for amendments to other articles. Articles other than I, II and XXX required a majority of two-thirds, while all other decisions required only a simple majority.

The annual meetings of the contracting parties were supplemented by the continuing work of the GATT council and its numerous committees, working groups and expert panels. The GATT was serviced by a Director General, a group of principal officers and a substantial secretariat. Specific disputes over trade-related issues between the contracting parties were investigated by panels established by the GATT.

A number of rounds of international trade negotiations were held under the auspices of the GATT, each of which was directed towards the progressive reduction of the tariffs charged on imports from other countries or QUOTAS imposed on the volumes of imports of different categories of imported goods and services. The early years of the GATT achieved relatively modest cuts in tariffs but contributed substantially to the avoidance of increased levels of any such direct restraints on trade. Later Rounds secured more substantial levels of tariff-reduction, but continued to suffer from a number of serious shortcomings.

The most obvious weakness of the GATT was the restrictions to tariffs and quotas. Such devices are merely the most visible of the restraints imposed by states on imports. As the GATT Rounds made progress on reducing or abolishing such restrictive practices, many states applied increasing ingenuity to the development and deployment of NON-TARIFF BARRIERS (NTBs) to trade. GATT negotiations also excluded trade in services and AGRICULTURAL TRADE (agricultural trade was the subject of parallel, but separate and limited, negotiations from 1965 onwards). It also provided explicit exemptions for preferential arrangements that were in force at the time of the signature of the GATT (such as the United Kingdom's system of commonwealth preference) and for any CUSTOMS UNIONS (CUs) and FREE TRADE AREAS (FTAs) that might be established. This latter exception was to become particularly important with the emergence of the EUROPEAN COMMUNITY (EC) in the late 1950s. A further weakness was the principle that the decisions of the GATT's panels on trade disputes could also be vetoed by the vote of any one of its members.

The GATT finally came to an end with the conclusion in 1994 of the URUGUAY ROUND, which was intended to correct many of the established failings of the GATT and its functioning, and the establishment of a fully fledged trade organization: the WORLD TRADE ORGANIZATION (WTO).

See also:

Dillon Round; Geneva Rounds; Kennedy Round; Tokyo Round; Torquay Round

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R.J. BARRY JONES

General Agreement on Trade in Services (GATS)

The General Agreement on Trade in Services (GATS) is a multilateral and enforceable agreement regulating trade in services and was negotiated during the URUGUAY ROUND of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) and signed on 15 April 1994. It is monitored by the WORLD TRADE ORGANIZATION (WTO), which is the body that superseded GATT. However, unlike the GATT and measures regulating intellectual property, countries make a specific commitment to opening service-industry sectors to international competition, which is a necessary provision in that development of service industries internationally lags behind that of manufacturing.

JOHN WALSH

General Agreement to Borrow (GAB)

The quota subscriptions of the member countries of the INTERNATIONAL MONETARY FUND

(IMF) are its principal source of financing. However, in 1962 the largest industrial countries became concerned that if any one of them were to draw on the resources of the IMF, the amount they could potentially borrow would significantly reduce the amount of usable resources readily available to other countries. Accordingly, they agreed to stand ready to lend to the IMF supplementary funds, to forestall or cope with an impairment of the international monetary system. This agreement is known as the General Agreement to Borrow (or the General Arrangements to Borrow).

Under the arrangement, the International Monetary Fund (IMF) is now able to borrow specified amounts of currencies from its member countries or their central banks under certain circumstances, at market-related rates of interest. The GAB has been renewed every four or five years, most recently in November 1997 for a further five-year period from 26 December 1998. In the late 1990s, the potential amount of credit available to the IMF under the GAB totalled SPECIAL DRAWING RIGHTS (SDRs) 17 billion, with an additional SDR 1.5 billion available under an associated arrangement with Saudi Arabia.

ROBERT LOONEY

general equilibrium

Should an economy be conceptualized by focusing on the most likely scenario or by constructing an ideal case? Augustin Cournot (1838) took the first route, analysing monopolistic conditions and treating PERFECT COMPETITION as a special case. Léon Walras (1874) opted for the second, by viewing the general equilibrium of a perfectly competitive economy as an ideal situation against which to gauge the inefficiencies of the actual system. Ultimately Walras' approach won out: the Walras Arrow-Debreu theory of general equilibrium is the theology of mainstream economics.

Perfect competition means that producers maximize profits under diminishing marginal returns, while consumers maximize utility

subject to a budget constraint. Firms' output is limited by rising marginal costs, whereas consumer's equilibrium is attained when the ratio of marginal utilities between any two commodities is equal to their price ratios. When prices rise, the consumer will shift demand towards the cheaper goods. The most intuitive way of proving the *existence* of a general equilibrium is to show that if it were possible to add up all consumers' demands for each good, any excess demand would be eliminated through a rise in prices. The economy would therefore behave like a representative consumer.

The epistemological significance of the hypothesis of perfect competition was well captured by John Hicks – one of the most distinguished economists of the twentieth century – according to whom 'a universal adoption of the assumption of monopoly must have very destructive consequences for economic theory' (Hicks, 1939: 83). Indeed, under MONOPOLY the expansion of output is constrained not by rising costs but by the size of the market. As a result, the effect of an increase in demand on prices can no longer be ascertained unambiguously. Later attempts to build a general equilibrium theory of MONOPOLISTIC COMPETITION have stumbled on the nature of the demand curve (Negishi, 1961). With perfect competition, demand curves are said to be objective because they are derived from the utility-maximizing behaviour of consumers. In a monopolistic situation, by contrast, the firm is assumed to perceive a possible combination between the demand and the price of its product *given* the actual demand and price expressed by customers. However, it has been argued that monopolistically competitive firms must perceive demand accurately also when in disequilibrium (Nikaido, 1975).

More than a century after its inception, the safest terrain of the theory of general equilibrium is still static competitive exchange. Yet here too a crucial problem exists. It is, in fact, by no means certain that individual demand functions can be aggregated for each commodity in order to yield conclusions similar to those obtained for the equilibrium of the consumer.

In particular, it is quite possible that the excess demand for a given commodity will rise when its price rises. The result violates the requirement that prices equilibrate supply and demand (Kirman, 1989). Given these dismal outcomes, it is no surprise that contemporary micro-economics – while expressing faith in general equilibrium theory – deals mainly with special cases (Tirole, 1988).

See also:

equilibrium theory; externalities; individualism, methodological; price elasticity

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JOSEPH HALEVI

Generalised System of Preferences (GSP)

The Generalised System of Preferences (GSP) is an international agreement through which developed countries provide tariff preferences to imports from developing countries. Its goal is to increase exports of manufactured and semi-manufactured goods from less developed countries, thereby expanding their development opportunities. Each developed country maintains its own preference system, with the GSP providing a set of loose guiding principles and a basis in international law for these otherwise separate schemes. The first was implemented on 1 July 1971 by the EUROPEAN ECONOMIC COMMUNITY (EEC) and the last was initiated on 1 January 1976 by the United States, but the arrangements are updated continuously.

The motivations for the GSP lie in the ethical premise that rich countries should assist the economic development of poor countries and the theoretical premise that development requires industrialization directed toward export markets in rich countries. As early as the Haberler Report issued by the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) in 1958, it was recognized that developing country exports faced high TARIFFS in developed countries and that the negotiating procedures of GATT based on RECIPROCITY were unlikely to generate relief to poor countries which lacked bargaining leverage. Indeed, a GATT review of the DILLON ROUND of trade negotiations (1960-1) revealed that only 160 of 4,400 tariff concessions covered products of export interest to poor countries.

Meanwhile, the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) secretary-general RAUL PREBISCH presented a report at UNCTAD I in 1964 which reaffirmed the thesis that developing countries must turn to exports of manufactured products to alleviate chronic trade deficits. EXPORT-ORIENTED INDUSTRIALIZATION could significantly reduce their over-reliance on primary products, which suffered

from price instability and slow demand growth. Invoking the infant-industry argument, Prebisch proposed a system of tariff preferences to bestow a margin of advantage to producers in poor countries over established enterprises in rich countries. Precedents were found in the framework of colonial systems, the Commonwealth and the Yaounde Convention of 1963 in which the EEC provided preferential tariff rates for imports from eighteen former colonies in Africa.

In 1968, UNCTAD II adopted a resolution recognizing 'the unanimous agreement in favour of the early establishment of a mutually acceptable system of generalised, non-reciprocal and non-discriminatory preferences.' While poor nations sought a permanent and binding commitment, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries were reluctant to impose upon themselves legal obligations to offer concessions without compensation, not only because of potential injury to their own industries, but also because it could undermine the principle of reciprocal concessions that underlies GATT negotiations, the chief avenue for trade liberalization since World War II. Thus, the GSP became entirely voluntary, with each rich nation tailoring its preference scheme to its own economic circumstances and remaining free to withdraw or amend it unilaterally. Many, especially the United States, have used threats of GSP withdrawal as a political tool on a variety of issues including human rights.

In June 1971, the legal foundation for the GSP was laid by a ten-year waiver of the obligations under Article I of GATT to offer 'MOST-FAVOURABLE-NATION treatment' without discrimination to all its contracting parties. In 1979, the life of the GSP was extended indefinitely by the 'enabling clause' of the Framework Agreement negotiated during GATT's TOKYO ROUND, which allowed developed countries to 'accord differential and more favourable (DMF) treatment to developing countries, without according such treatment to other contracting parties'.

The schemes of various nations differed and each has evolved over time. The initial goal was

Geneva Convention

to make all imports of manufactured and semi-manufactured products from all developing countries entirely duty free. In fact, preferences have also been extended to many other industrial raw materials and agricultural products, but universality has not been achieved in product coverage, preference margins, or beneficiary countries. With some notable exceptions (especially textiles, footwear and transport equipment), most GSP schemes cover well over 90 per cent of industrial product categories and more than 50 per cent of agricultural products, but exclusions for industries considered 'sensitive' because of economic distress in rich countries are common. While most industrial products are duty free in the three largest schemes (United States, the European Union and Japan), others offer only tariff reductions ('preference margins'). GSP benefits have declined as most-favoured-nation (MFN) tariff rates have been reduced; by the mid-1980s, about 40 per cent of exports from GSP beneficiaries to OECD countries were duty free under MFN even without the GSP. Given product exclusions and QUOTAS that limit the volume of goods eligible to receive preferences, only about 10 to 20 per cent of total exports from beneficiary nations to the Organisation of Economic Co-operation and Development (OECD) actually receive GSP treatment.

The list of beneficiary countries has generally included most non-OECD countries, with occasional exceptions for controversial cases like Taiwan, China, North Korea, Afghanistan, Ethiopia and Mongolia. The most spirited controversies over the GSP have concerned the issue of 'graduation', the principle that some less-developed nations will eventually achieve a level of competitiveness and prosperity that disqualifies them from DMF treatment, at which point they should also assume the full obligations of a contracting party of GATT, including granting such preferences to others. Because no formal criteria were developed initially, any nation claiming less-developed status could qualify for DMF treatment. Indeed, prior to their accession into the European Community in 1986, both Spain

and Portugal received GSP preferences. In 1984, however, individual nations led by the United States and New Zealand began to apply criteria in the form of GNP per capita limits. While graduation has affected a small number of nations, they account for a considerable share of GSP trade. In the mid-1980s the top three beneficiaries – Hong Kong, Korea and Taiwan – received about 45 per cent of the total gains from the GSP, but by the mid-1990s all three, along with several others, had become ineligible through graduation by most schemes.

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BRUCE E. MOON

Geneva Convention

The Convention Relating to the Status of Refugees was adopted by the United Nations in 1951 in Geneva. It is the principal international legal instrument for determining entitlement to protection and assistance as a refugee.

The convention defined as a refugee 'Any person who [must flee their country] as a result of events occurring before 1 January 1951 and owing to a well-founded fear of being persecuted for reasons of race, religion, nationality, membership of a particular social group or political opinion'. The geographical scope of the convention is limited to Europe.

The limitations of time and space reveal the historical experience of Fascism and Stalinism out of which the convention emerged. However, starting with the displacements resulting from the separation of India and Pakistan in 1948, it became clear that these limitations were at odds with the new realities of DECOLONIZATION. In 1967, the New York Protocol – which eliminated these limitations – was appended to the convention.

With the impact of the crisis in the global economy of the 1970s and of the DEBT CRISIS

and ensuing restructuring of the global political economy, the discrepancy between the legal asylum regime and the new political and economic realities grew considerably. Among many experts, the call for a fundamental reorientation of asylum policies grew louder. However, in the general political climate prevailing in the Western countries, politicians and governments have turned to an increasingly restrictive interpretation of the existing regime and to intensive intergovernmental cooperation to increase the effectiveness of asylum policies.

HENK OVERBEEK

Geneva Rounds

Two of the rounds of negotiations under the auspices of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT). The first Geneva Conference (1947) resulted in GATT, which is an international agreement for the elimination of tariffs, quotas and preferential trade among the participants, as well as for the gradual LIBERALIZATION of world trade. The agreement, which was signed by twenty-three member-nations, came into effect on 1 January 1948. The fourth round of negotiations (1955–6) among GATT members also took place in Geneva, where the first major amendment of GATT was ratified. In 1995, GATT developed into the WORLD TRADE ORGANIZATION (WTO), which has 123 member-nations and whose secretariat is still Geneva-based.

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ARISTIDES N. HATZIS

geo-economics

Geo-economics is the concept coined by Edward Luttwak (1990) to describe the nature of state rivalry after the COLD WAR. While the latter era was dominated by military and strategic issues, or geopolitics, in the contemporary era geo-economics describes a different form of competition where state prominence is measured by economic prowess.

The contrast with the Cold War is important because Luttwak initially came to prominence as a 'security expert' in the 1980s: he reinvented himself in the 1990s as an 'economic security expert' (O'Tuathail, 1996). Thus he has been concerned with maintaining a world model of the United States under threat from enemies abroad: geo-economics replaces the USSR with Japan (Luttwak, 1993). Although his arguments are laced with references to GLOBALIZATION – Japan has adapted to it better than the United States – in fact his analysis remains in a realist, statist mode (see REALISM; STATISM). Spatial referents have not changed, merely the methods of state competition are altered. Hence, rather than a contribution to debates about globalization, geo-economics is a rediscovery of MERCANTILISM.

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PETER J. TAYLOR

geographical concentration of exports

Geographical concentration of exports refers to a situation in which the bulk of a country's exports are sold to one, or a few, markets

abroad. Concentration may be the result of a country's proximity to a foreign market – particularly if that market is large – and the associated lower cost of transport and marketing. Particularly in small countries, geographical concentration is encouraged by the need to secure economies in production and distribution. However, in many cases, historical commercial relationships between states (as in the case of former colonies) and preferential arrangements (like the LOMÉ CONVENTIONS) seem to have played a major role in shaping the pattern of trade. The geographical concentration of the exports of some Pacific islands on Europe is a good example. Often geographical concentration is associated with concentration on a narrow range of primary commodities, while markets for manufactured exports and services tend to be more diversified. Such concentration increases a country's exposure to external shocks. Risk may arise from changes in the level of demand for exports, currency fluctuations and other developments in principal export markets. At the same time, the repercussions stemming from any tariff and trade dispute tend to be wider. Last but not least, there is the risk of pressure from more powerful trading partners to force concessions on trade and other issues.

See also:

diversification

Further reading

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LUCA MONGE ROFFARELLO

geopolitics

'Geopolitics' is a widely used term with various meanings and a decidedly chequered past. Sometimes the term is used as a synonym for political geography or the spatial dimensions of politics. In other uses it refers to international great-power rivalries, the geographical factors in a state's foreign policy and, sometimes, more specifically to struggles for strategic control over specific areas of the earth's surface. 'Geopolitical' has also been used as an adjectival synonym for international politics that emphasizes high politics and military matters in specific contexts. In political debate the slippage between these meanings has sometimes been a very useful rhetorical device suggesting simultaneously intellectual acumen and political gravitas.

Not surprisingly, the term 'geopolitics' has often been related to the academic discipline of geography, but many important writers and politicians who have used the term have not been formally trained as geographers (Parker, 1985). Credit for coining the term is usually given to Rudolf Kjellen, a late-nineteenth-century Swedish intellectual and conservative politician heavily influenced by German sources, especially Friedrich Ratzel's *Politische Geographie* (1897). Ratzel's important analogy of the state as an organism, when linked to Darwinian ideas of the survival of the fittest, suggested that international politics was a struggle for 'living space' and implied that larger states would better survive and do so at the expense of smaller and weaker ones. These themes were often linked to contemporaneous ideas of environmental DETERMINISM which argued that specific environmental factors determine the course of human affairs. These ideas were in turn linked to the themes of imperialism and imperial rivalries (see IMPERIAL RIVALRY; IMPERIALISM) to set the context for much of the geopolitical writing of the early part of the twentieth century (Godlewska and Smith, 1994).

Arguably the most important proponent of what came to be known as geopolitics was the British geographer HALFORD J. MACKINDER,

although he himself disliked the term and avoided its usage (O'Tuathail, 1992). Mackinder argued that imperial expansion had culminated in a global closure of political space and hence that future state rivalries could no longer find outlets through colonial competition.

Mackinder's (1904) essay on 'the geographical pivot of history' postulated a 'key' pivot area (later renamed 'the heartland') on the earth's surface in central Asia that would, with the coming of railways and hence rapid communications, he argued, allow its occupier to dominate the landmass of Asia and hence the world. Written in the shadow of the declining British imperial hegemony in the early twentieth century, this paper and the later book, *Democratic Ideals and Reality* (1919), picked up the theme of the global struggle of landpower and seapower that had been written about by American naval strategist Alfred Thayer Mahan earlier in *The Influence of Seapower upon History* (1890).

After World War I, and stimulated by many Germans' sense of the injustice of the Versailles Treaty provisions which reduced German territory, many of the geopolitical ideas were developed in Germany. Their most prominent thinker was Karl Haushofer, who adopted Kjellen's term *Geopolitik* and Ratzel's notions of *lebensraum* to provide a framework for an 'applied science' suitable, he argued, for analysing the regional contexts and foreign policies of states. A prolific writer, and editor of the political journal *Zeitschrift für Geopolitik*, which often advocated the return of territory lost after World War I, his connections through friendship with Rudolf Hess to the Nazi Party ensured considerable use of his geopolitical ideas for Nazi propaganda purposes. The *Zeitschrift* spawned emulators elsewhere in Europe, like the Italian *Geopolitica*. The emphasis in Haushofer's writings on military matters was also picked up in South America, where national security doctrine has often since been discussed in terms of geopolitics. However, many facets of the Nazi war strategy – and the invasion of Russia in 1941 in particular – went against Haushofer's geopolitical ideas

of a continental alliance in opposition to what he understood as British naval-based global power.

Nonetheless, American wartime propaganda in particular suggested that geopolitics was the key to Nazi plans for world domination and American writers quickly adopted some of the motifs of geopolitical analysis to reconsider American wartime strategy and post-war foreign policy. Notably Nicholas Spykman (1942), who taught international affairs at Yale University, modified Mackinder's heartland theory to emphasize the importance of the global contest between landpower and seapower in the Asian 'rimlands'. The post-war foreign policy of containment had many of the hallmarks of Spykman's rimland theory and the struggle between naval and land power, although George Kennan (1947) (the author of the term 'containment') did not use the terms 'geopolitics' or 'rimland' in this formulation of the policy.

The term 'geopolitics' was, however, tainted by associations with Nazi uses of the term *Geopolitik*, and while some of the themes of classical geopolitics continued to be discussed, the term itself fell into relative disuse (Sloan, 1988). Instead, after the war terms like 'national security', 'containment' and 'deterrence' were linked to geographical descriptions of the Soviet bloc and the Atlantic alliance in the rapidly expanding field of INTERNATIONAL RELATIONS (IR), which provided Western experts who dominated the discussions of global politics and strategic studies. In the communist world 'geopolitics' was equated with Nazi and capitalist imperialism, and was used only as a term of polemical derision. With the exception of a few writers (Cohen, 1963), political geography analyses of global politics languished and outside South America the term 'geopolitics' was used rarely, even when explicitly geographical factors were taken seriously in discussions of strategy and foreign policy.

In the 1970s the use of the term 'geopolitics' and its analytical importance in strategic discourse was revived. The popularization of the term is usually linked with Henry Kissinger's

use of it, but he has been careful to avoid defining it beyond claiming that it relates to equilibrium among major powers. The term was linked to concerns about 'Soviet expansionism' in the late 1970s in the United States, amid discussions of arcs of crisis in the Middle East and the declaration of the Carter doctrine designed to forestall Soviet military involvement in the Persian Gulf. Colin Gray (1977, 1979), a strategist of considerable influence in late-1970s debates about the SALT arms agreements and an adviser to the Reagan administration, revived Mackinder and Spykman's ideas in a number of essays and linked them directly to the formulation of US nuclear strategy during the period of the second Cold War (Dalby, 1990).

In part in reaction to these developments, political geographers in the English-speaking world have once again turned their attention to matters of global power in its geographical context and once again discuss these matters under the rubric of 'geopolitics' (O'Sullivan, 1986). But in most cases these writers, unlike their forebears early in the twentieth century, are now highly critical of state policies and do not aspire to give practitioners of statecraft advice leading to state aggrandisement. Simultaneously in France in the 1970s, Yves Lacoste and other authors associated with the journal *Herodote* reinvented the term as an analytical focus to examine the global operation of political power in specific places in a critical manner that avoided giving policy advice to specific national political elites.

Part of the reason for these new critical developments was driven by concern about the dangers of COLD WAR confrontation and a recognition that many of the elements of the global crisis were interconnected with political structures of the Cold War (Johnston and Taylor, 1986). Within geography, geopolitics is now understood in relation to wider concerns with POVERTY, UNDERDEVELOPMENT, violence, militarization and environmental degradation. In addition, geography as a discipline was influenced in the 1970s by materialist approaches to social science. Drawing on neo-Marxist political economy (see NEO-MARXISM

and, in the case of leading practitioner Peter Taylor (1993), WORLD-SYSTEMS THEORY, the economic dimensions of global politics were worked into reconsideration of the geographical dimensions of global politics.

Most recently, some scholars influenced by critical theory and post-structuralist theory (see CRITICAL THEORY; POST-STRUCTURALISM) have analysed the discourses of contemporary international politics and the geographical assumptions informing policy under the rubric of 'critical geopolitics' (O'Tuathail, 1996). The use of the oxymoron is intended to signal that the supposed fixed arrangements of geography are now understood as being temporary social constructions of space that will change as political, economic and technical forces lead to spatial reorganization. A major work by John Agnew and Stuart Corbridge (1995) has developed the themes of critical geopolitics in a synthesis that analyses traditional geopolitical concerns with great-power rivalry and links them to an examination of global political economy and the use of geo-economic discourses (see GEO-ECONOMICS) as part of a series of practices used by statecraft to 'master space'.

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SIMON DALBY

Gerschenkron, Alexander (1904–78)

Shortly after the BOLSHEVIK revolution of 1917, Gerschenkron's family moved from Odessa, in Russia, to Vienna where he completed his secondary education. He took a doctorate degree at the University of Vienna which was at the time a centre of both NEO-CLASSICAL ECONOMICS and 'Austro-Marxist' economics. In 1938, at the time of Hitler's invasion of Austria, he migrated again, this time to the United States where he was to be based for the rest of his life. He spent six years at the University of California, four years in

the Federal Reserve in Washington and then, in 1948, joined the faculty of Harvard University.

At Harvard, Gerschenkron taught both economic history and Soviet studies and, in the early 1950s, he published important work on the 'index number' problems of measuring industrial output in the Soviet Union. However, he is best known for his *Economic Backwardness in Historical Perspective* (1962). As the title implies, this was a model of late-comer economic development, in which 'lateness' can be an advantage due to the short-cuts to advanced technology which are possible. Gerschenkron emphasized that relative backwardness was likely to require a greater focus on producer rather than consumer goods, on capital-intensive rather than labour-intensive technologies and dependence on borrowed rather than indigenous technologies. However, Gerschenkron stressed that these short-cuts and the associated 'big push' in investment required institutional innovation to substitute for private, corporate capital. These institutional innovations took the form of investment banks in France, Germany and Austria, and more direct government intervention, even in 'later-comers' such as Russia.

Gerschenkron's writing on economic backwardness was derived from detailed research into the specific development experiences of a large number of European countries. His approach inspired and influenced similar studies on other (non-European) late-comers such as Rosovsky's (1961) work on Japan, as well as many more-recent studies on the other NEWLY INDUSTRIALIZED COUNTRIES (NICs) of East and South-East Asia.

The sharpest criticism of Gerschenkron's writing on economic backwardness has been in terms of too little attention being paid to the analysis of the domestic classes and groups whose interests have to be confronted and incorporated by the interventionist state. This alleged omission is, perhaps, surprising in view of Gerschenkron's earlier *Bread and Democracy in Germany* (1943), which argued that the breaking of the power of the Prussian *Junkers* was a necessary precondition for the democratic development of post-war Germany and

Gilpin, Robert G. (1930–)

for a peaceful Europe. However, it is widely acknowledged that Gerschenkron has few equals, past or present, in his command of comparative economic history.

See also:

authoritarian states; developing countries; development; economic growth; Hirschmann; Veblen

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CHRIS EDWARDS

Gilpin, Robert G. (1930–)

A Professor of Politics and International Affairs at Princeton University, Robert Gilpin produced six major books and numerous important articles in a career that has spanned roughly forty years. Gilpin is among the most distinguished US specialists in international relations (IR) and has made major contributions to international political economy (IPE).

Gilpin's early work (*American Scientists and Nuclear Weapons Policy*, 1962; *France in the Age of the Scientific State*, 1968) explored the interplay of science, technology and public policy. He became widely recognized as a leader in the revitalized field of IPE during the 1970s. His *US Power and the Multinational Corporation* (1975) was instrumental in shaping the intellectual agenda for that subfield. Gilpin's typology of three conceptions of IPE – Marxism (see MARXISM–LENINISM), LIBERALISM and MERCANTILISM – helped to create a framework that informed both teaching and

research in the field during the 1970s and 1980s.

The important substantive contribution of *US Power* was to stake out a position on the all-important issue of the relationship between states and markets. Gilpin cut against the emerging conventional wisdom by arguing that MULTINATIONAL CORPORATIONS (MNCs) were not all-powerful autonomous actors and that their expansion did not foreshadow a new era in international politics. The rise of the MNC or of any other variety of international economic exchange was a function of the particular distribution of power in the international system at the time. For Gilpin, politics drove markets. The liberal world economy of the post-war era, like that of the nineteenth century, did not arise spontaneously but was the product of a particular political order: it reflected the interests and grand strategy of the dominant actor of that era. Gilpin used this insight to provide a broader understanding of the relationship between the economic and strategic dimensions of US COLD WAR diplomacy and of US interactions with its allies in Western Europe and East Asia. His arguments, along with those of CHARLES KINDLEBERGER, laid the foundation for what was later termed HEGEMONIC STABILITY THEORY.

In *War and Change in World Politics* (1981), Gilpin generalized and formalized his account of hegemonic rise and decline into a model of international CHANGE. The construction of any international order, he argued, reflected the power and interests of dominant actors. Over time, however, political, economic and technological developments altered the initial distribution of power and privilege, in accordance with the 'law of UNEVEN DEVELOPMENT'. As the distribution of power shifted, rising states sought to revise the international order to reflect their own power and interests, while declining states sought to arrest the transformation and preserve their dominance. At the centre of the international system, this process of change and resistance to change took the form of hegemonic war, as evidenced by the Peloponnesian Wars in ancient times and the wars and settlements of 1648, 1713, 1812, 1918

and 1945 in the modern state system. Gilpin devoted attention at the end of *War and Change* to whether nuclear weapons have rendered hegemonic war obsolete as an instrument of great-power diplomacy. He concluded with 'guarded optimism' (Gilpin, 1981: 234) that a process of peaceful change rather than hegemonic war would characterize the resolution of the US-Soviet Cold War struggle.

Gilpin's emphasis on the inevitability of uneven development and the cyclical nature of hegemonic rise and decline led him to be pessimistic regarding the future of US hegemony. *War and Change*, in fact, foreshadowed many of the arguments of the declinists of the 1980s, most notably Paul Kennedy and Samuel Huntington. In Gilpin's subsequent book, *The Political Economy of International Relations* (1987), the argument of US hegemonic decline comes across most clearly. For Gilpin, US decline was a function of the diffusion of US technology, for security reasons, to its Cold War allies in Western Europe and Japan. It was also a product of the mismanagement of the US domestic economy, as indicated by sizable trade and budget deficits, excessive military spending and lagging productivity. Gilpin identified a shift in the locus of international economic activity from its European core to the Pacific as an important consequence of US relative decline and he focused considerable attention on the Japanese challenge to US economic dominance. Gilpin, characteristically, placed this struggle in historical perspective, viewing the US Japanese competition for mastery of the technologies of the information revolution as similar to the transformations that led to British economic hegemony after the Napoleonic Wars, the rise of Germany and the United States in the late nineteenth century, and the dominance of the United States after 1945. In retrospect, his analysis seemed to overestimate the strength and appeal of the Japanese model of political economy and to underestimate the resilience of the US economy and the potential for hegemonic renewal of the United States.

The arguments in Gilpin's latest work, *The Challenge of Global Capitalism* (2000), are built

again on the insight that international economic activity must have a secure political foundation. GLOBALIZATION today is no more self-sustaining than was the LAISSEZ-FAIRE international economy of the nineteenth century or the BRETTON WOODS SYSTEM of the mid-twentieth century. And Gilpin worries that the contemporary political foundations for international economic liberalism are fragile. The end of the Cold War removed the important security rationale for economic cooperation among advanced industrial states. The multilateral trading system is challenged by economic REGIONALISM, by the divergence of national styles of capitalism in the United States, Europe and Asia, and by the tendency of globalization to exacerbate the divide between economic winners and losers within and between nation-states. The United States, for its part, seems less willing and able to provide the kind of leadership and commitment to openness that it provided during the golden era of US hegemony. As in Gilpin's 1987 book, *Challenge of Global Capitalism* builds synthetically and comprehensively on a survey of the trade, monetary, investment and financial dimensions of the contemporary world political economy.

Gilpin's intellectual style is to synthesize and integrate rather than partition and simplify. He draws on a variety of theoretical, intellectual and disciplinary perspectives in constructing his explanations for IPE. The law of uneven development is borrowed from LENIN and Gilpin's model of international change draws self-consciously on economic and sociological modes of theory construction. He finds inspiration in the arguments of liberal economists, geopolitical strategists and classic political theorists.

Nevertheless, the core insights of Gilpin's work are most informed by the realist intellectual tradition (see REALISM). Gilpin wrote two spirited and widely read defences of the realist tradition: 'The richness of the tradition of political realism' (1984) and 'Nobody loves a political realist' (1997). As these articles make apparent, Gilpin is more interested in the richness of classical realism than in the

Gini coefficient

scientific (or, to its critics, pseudo-scientific) rigour of structural realism or neo-realism. Gilpin's realism is that of Thucydides, E.H. CARR and Hans Morgenthau. His working assumption, as he put it at the beginning of *War and Change*, is that:

the fundamental nature of international relations has not changed over the millennia. International relations continue to be a recurring struggle for wealth and power among independent actors in a state of anarchy. The classic history of Thucydides is as meaningful a guide to the behavior of states today as when it was written in the fifth century BC.

(Gilpin, 1981: 7)

Gilpin, to be sure, recognizes and appreciates profound transformations such as the INDUSTRIAL REVOLUTION, the advent of nuclear weapons and the contemporary information revolution. But his work taken as a whole is an eloquent statement that continuity outweighs change in the history of world politics.

See also:

economic realism; hegemony, US; mercantilism; neo-mercantilism; war cycles

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MICHAEL MASTANDUNO

Gini coefficient

The Gini coefficient is a common measure of the degree of inequality (or equality) for distributions of economic variables such as the DISTRIBUTION OF INCOME; it is named after its originator. A Gini coefficient is the ratio of two areas in a graph of a distribution.

Consider a line reflecting total equality in an income distribution. If each member of the population had the same income, then graphing the cumulative percentage of income received by the associated percentage of the population on the vertical axis with the cumulative percentage of the population on the horizontal axis would result in a 45° line: any 1 per cent of the population would have 1 per cent of the income; any 50 per cent of the population would have 50 per cent, and 99 per cent of the population would have 99 per cent of the total income. This can be called 'the line of complete equality'.

Then consider a population with an unequal distribution. Rank order the population by income size and graph the cumulative percentage of income accruing to the population, beginning with the poorest. This line, known as a LORENZ CURVE, would fall below the line of complete equality; if, for example, the poorest 20 per cent received 10 per cent of income, this point would be below 20 per cent of the population and 20 per cent of income – the corresponding point on the line of complete equality.

If the area between the line of complete equality and the Lorenz curve is called *A*, and the area under the Lorenz curve is called *B*, the ratio of area *A* to the total area *A* + *B* is the

Gini coefficient. With complete equality, the Lorenz curve and the line of complete equality are the same, so the Gini is 0. With complete inequality (one member of the population receives all the income), the Gini is 1 ($A = A + B$). Estimates of Gini coefficients for economies' income distributions range from around 0.2 for the most equal to 0.5 for the most unequal. Such small differences are relatively important: twice the Gini coefficient is equal to the expected absolute difference in incomes, relative to the mean, between any two persons drawn at random from the population.

Although it is the most commonly used measure of inequality, the Gini has several weaknesses. Lorenz curves can cross; if so, two populations with the same Gini coefficient could have very different degrees of inequality over portions of their distribution (one might have a flat Lorenz for the poor, indicating lots of equality among the poor; another might be flatter towards the rich end of the distribution). Another commonly used measure of inequality is the Atkinson coefficient, in which a subjective value is assigned to the degree of inequality aversion to detect changes in distribution affecting units on the lower tail of distribution (namely, the poor).

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CHRISTOPHER J. NIGGLE

Glass-Steagall Act

'Glass-Steagall' is the commonly used name for the US Banking Act of 1933. It was enacted to separate commercial and investment banking activities. Under Glass-Steagall, commercial banks may be linked to separate investment service corporations under holding companies.

The act's provisions do not extend to US banks' overseas activities.

DEAN M. HANINK

GLOBAL CITY *see* world city

global reach

The basic implication of the term 'global reach' is that business firms and political organizations, such as nation-states, are characterized by varying capabilities and ambitions to operate on wide geographical scales. Most firms have tended to operate on local or national scales as they compete in close-at-hand markets. The foreign policies of most states are also restricted to their immediate environs, which may be a small set of proximate states or a larger set that is referred to as a region.

But, if capabilities and ambitions are variable, so too is the scale of organizational activities. Increasingly in the business community, but less so in the political world, some organizations operate on a very wide scale. The GLOBALIZATION of business means that firms produce commodities in various venues and operate in markets around the world. Globalization also implies that the barriers to such operations have decreased as the world economy has become more open. In the information age, presumably, transaction costs will be decreased even further, allowing small firms to compete on a planetary-wide basis.

In the 1960s and 1970s, the emergence of transnational corporations (TNCs) operating in many different countries and markets – some with access to greater resources than many nation-states could claim – worried a number of observers (see MULTINATIONAL CORPORATIONS (MNCs)). The fear was that many of these corporations could no longer be controlled by nation-states, either in the North or the South. Since that time, the great potential for corporate autonomy persists, but a good

deal of the fear or alarm seems to have subsided. In an era characterized by rapid technological change, globalization and privatization, TNC activity seems more likely to be welcomed than criticized. Empirical evidence appears also to substantiate the claim that TNCs are less transnational or global in terms of ownership, management, headquartering and even operations than is often thought to be the case. None of this implies that TNC activities are potentially less worrisome from the perspective of state managers, but only that public concerns about this phenomenon are currently less vocal than in the past.

States have a different type of problem. Rather than reducing production costs by finding inexpensive labour or by marketing products in distant theatres, their concern is one of overcoming the geographical limitations on the scope of their influence. From a realist perspective, the policy problem often reduces to whether military force can be applied over long distances. Such a capability remains limited, as it long has been, to a small elite group of states, usually referred to as 'great' or 'major powers'. But even within these elite groups, the capability to project force over long distances has tended to be uneven.

Historically, force projection at long distance has been synonymous with naval power and, more recently, with air and space power. In a world in which water encompasses some two-thirds of the earth's surface, navies have been necessary to transport troops and weapons to distant zones. They have also been necessary to protect the inter-regional commercial routes which states have contested as means and ends motivating their long-distance force projections.

Global reach in this context first began to emerge in the fifteenth century. The aborted Chinese expeditions earlier in the century stopped short of circumnavigating Africa. By the end of the century, though, Portuguese ships were beginning to find their way around Africa into the Indian Ocean, just as Spanish ships were entering the New World (operating under the misapprehension that still another route to Asia could be developed). With these voyages began a gradual acceleration in the

trend towards greater economic interdependence between western and eastern Eurasia, and one that forcibly integrated the Americas and more of Africa into the world economy. Note that while the Americas had been effectively outside the world economy up to the sixteenth century, western and eastern Eurasia (as well as parts of Africa) had long been characterized by at least intermittent levels of interdependence.

The states able to move outside their regional seas thus acquired global reach. They were the political-military organizations engaged in inter-regional transactions, primarily by sea. At first their ability to project force was highly limited to coastal areas and the extent to which ship-borne cannon could bombard Afro-Eurasian ports and cities. This capability, however limited, was never a European prerogative. Rather, only a few western European states were active in long-distance trade and conflict. In the sixteenth century, Portugal and Spain led the way before eventually being eclipsed by the Dutch and later the English in the seventeenth and eighteenth centuries. Britain excelled at global reach in the nineteenth century, just as predominance in the twentieth century has been monopolized to a large extent by the United States.

The hierarchy inherent in global-reach activities over the past five centuries has created a global political economy characterized by periods of high and low concentration. Periods of high concentration are associated with a single state monopolizing economic innovation and naval superiority. With these attributes comes a leading responsibility for the management of transregional or transglobal transactions. But as the innovations diffuse and competitors catch up, the naval lead tends also to erode. As power, wealth and influence, and therefore global reach, become less concentrated, global political economy becomes more conflictual. While this cycle of concentration and deconcentration has characterized global politics and economics for at least the past five centuries – if not longer – there is no reason to assume it must continue to persist into the future. However, public global reach remains

highly restricted, while private global reach continues to expand. The former is traditional; the latter is less so. How these two opposing trends will play themselves out, and with what political-economic consequences, remains to be seen. Presumably, though, these developments are highly suggestive of fundamental transformations underway in the global political economy.

See also:

multinational corporations (MNCs); multinational enterprise (MNE), structures and strategies of

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WILLIAM R. THOMPSON

global society

A global society can be said to be coming into existence at the beginning of the twenty-first

century, to the extent that the framework of social action is global, rather than national and international, relations.

Sociologists have used the term *SOCIETY* in two senses (Giddens, 1985: 163): in general, it refers to *social relations*; in particular, it refers to a society or societies – namely, given *frameworks of social action*. Social action is, therefore, at the same time open and bounded: it both defines and is defined by social relations – that is, it is structuring the structured. *Social relationships* are relatively stable, ongoing forms of social relations through which social action achieves its structured or bounded quality. *Societies* are larger-scale, complex sets of social relationships which can be said to give the strongest definition to the structured and bounded quality of social action in general.

In modern sociology, there has been an ambiguous relationship between theories concerned with the larger networks of social relations belonging to modern Western civilization as a whole, and the tendency of analysis to assume *national societies* – that is, frameworks of social action defined by *NATION-STATES*. Theories of *CAPITALISM* and industrial society have concerned themselves with society on a Western or world scale. However, most analysis has operationalized such categories in national terms – for example, British capitalism or American society. In this sort of analysis, relations between national societies have been defined as *international* and cross-national analysis has been accomplished by the *comparative method*, comparing national societies.

As the historical sociologist Michael Mann points out,

In major transitions the fundamental inter-relations, and very identities, of organizations such as 'economies' or 'states' become metamorphosed. Even the very definition of 'society' may change ...

(Mann, 1993: 9)

This is what is happening in the current period. Because of an increase in transnational relations of certain kinds, national societies and international relations have been seen as less

adequate frameworks within which to understand social action. According to many writers, GLOBALIZATION means that social action increasingly takes place on a global scale.

These changes have been seen as undermining the nation-state. The most fundamental change, however, is that nation-states and inter-state relations in core world-regions have become part of a Western bloc of state power, claiming global legitimacy through the UNITED NATIONS (UN) system. Just as nation-states defined national societies, so a new global structure of authority relations and state institutions lies behind the new patterns of society.

It can therefore be argued that a global society is coming into existence to the extent that a common global framework, rather than the old national society, is the defining context of action. Shaw (1994: 3–28) has argued that a global society is an emergent rather than a finished reality, and a very different *kind* of society, first because it is a maximum concept which includes all social relations and second because it includes the old national societies.

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MARTIN SHAW

global strategy

The term 'global strategy' is usually associated with the planning procedure adopted by governments, firms and other organizations in the nineteenth and twentieth centuries. Strategy may be defined as planning ahead to secure advantage or the furtherance of one's aims. Thus, global strategy is characterized by the construction of such a plan for future action, through the consideration of that action on a worldwide scale. It may be formalized, as a document or public statement, or exist only in an informal manner (for example, as a set of generalized rules for operation). Not only states and firms but also other types of international and transnational organization can have global strategies: other organizations with global strategies include religious organizations (such as Christian churches), charitable bodies (such as Oxfam), pressure-groups (such as Greenpeace) and cultural organizations (such as the Olympic movement).

The ability to formulate a global strategy depends on several factors: the existence of worldwide aims, the perception that there is a means by which these could be achieved and the construction of a plan for accomplishing this. It also depends on a perception of what is 'global' and on geographical knowledge. Before the nineteenth century, the construction of a true global strategy was not possible, as no government or firm had access to reliable geographical data about the whole globe on which it could base such a strategy. However, misconceptions about world geography led governments to build global strategies at a far earlier date than this. For example, in Europe from at least the time of Alexander the Great, empires attempted to construct such a strategy. This might be based on a programme of conquest, as in Alexander's case, or the belief that large areas of the globe were worthy of consideration for imperial rule. These examples, show the extent to which effective global strategy is as dependent on the acquisition and effective processing of reliable knowledge

about the world as it is on purely 'strategic' reasoning.

The first of the two classic periods of global political strategy was, perhaps, in the nineteenth century, when European states competed for imperial control of (or privileged access to) every region of the world. An excellent example of this competition is the 'Great Game'. This was a phase of intense and prolonged inter-imperial competition for strategic dominance in nineteenth-century Central Asia. In the twentieth century, global strategy may take a very wide range of forms. Governments can have, for example, political, military, economic, ideological or cultural aims which require a global strategy. This is exemplified by the respective strategies of the United States and USSR during the second classic period of global political strategy: the Cold War. Then, military and political competition was much more firmly formulated in ideological terms and less significance was assigned to the direct imperial control of territory. New global strategic concepts, such as 'containment' were also developed during this period. Economic strategies have often accompanied these political and military ones, but have also been conducted partly independently of them. Firms tend, of course, to have primarily economic aims in their global strategies but these too may have other (for example) political aspects. A degree of overlap exists between governmental and economic strategies and this can be seen in both of the 'classic' examples already cited. In each case, economic activities were restricted and shaped by political considerations. Since 1945, the formulation of global economic strategies by firms has become especially associated with multinational or transnational corporations (see MULTINATIONAL CORPORATIONS (MNCs)). This is understandable, as the scope of operations of such corporations necessitates some sort of global strategy, if only an informal one. Competition between such corporations, in particular, has led to the conduct of global strategy by firms on a scale previously reserved for governments.

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WILLIAM R. THOMPSON

global warming

The controversy surrounding global warming can be traced to the 1990 Intergovernmental Panel on Climate Change (IPCC) finding that the Earth's climate is changing in response to human activity. Although the mean surface temperature of the earth had increased by less than 1°C in the previous 100 years, the IPCC anticipated rising sea levels, changes to rainfall patterns, the growth of tropical disease and increasing numbers of environmental refugees (in Bangladesh, for example, up to 25 million people could be displaced by 2050) unless significant changes to the pattern of economic development occurred. The conflict over global warming stems both from the different capacities of states in the developed and DEVELOPING COUNTRIES to respond to such challenges and from the imbalance in their current emissions of greenhouse gases or GHGs (the principal cause of global warming).

The UNITED NATIONS (UN) has sponsored a series of climate conventions to agree a framework to cut emissions of these gases (see GLOBAL WARMING (UN CLIMATE CHANGE

global warming (UN Climate Change Convention)

CONVENTION))), but as the conflict over global warming is essentially a conflict over both energy-use and the pattern of industrialization, reaching agreement has proved difficult. In particular, the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) and the United States have continued to emphasize the scientific uncertainty over the IPCC's findings to legitimize their continued reliance on fossil fuels.

In fact, global warming requires a fundamental change in relations between developed and developing countries, involving TECHNOLOGY TRANSFER, widespread lifestyle changes in the industrialized countries and challenges to the existing assumptions within CAPITALISM that energy-use and economic growth are inextricably linked.

See also:

environmental security; sustainable development

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NICK ROBINSON

global warming (UN Climate Change Convention)

Responding to the potential dangers of human interference with the global climate system, the international community concluded the United Nations Framework Convention on Climate Change (FCCC) in 1992 and strengthened its

obligations with the Kyoto Protocol in 1997. Despite these achievements, progress on decisively curbing the potential threats posed by climate change has been limited and crucial aspects of the Kyoto Protocol are in need of further clarification.

Climate challenge

The *natural* greenhouse effect permits human survival on planet Earth. Human interference with the climate system by way of anthropogenic emissions of greenhouse gases (GHGs), mainly carbon dioxide, methane, nitrous oxides and CHLOROFLUOROCARBONS (CFCs) result in the *enhanced* greenhouse effect which may alter the natural climate pattern. Inquiries into the causes and effects of climate change have been undertaken by the Intergovernmental Panel on Climate Change (IPCC) which has been created by the UNITED NATIONS ENVIRONMENT PROGRAMME (UNEP) and the World Meteorological Organization (WMO). In their Second Assessment Report, IPCC concludes that 'the balance of the evidence suggests that there is a discernible human influence on global climate' (IPCC, 1995).

The effects of climate change will vary greatly across the regions of the world, with some regions facing adverse effects while others may benefit. Fears of increasing sea-levels (for low-lying countries), the spread of malaria or other diseases, more pronounced dry periods in already arid areas, enhanced river floods and the reversal of ocean currents, led the international community to consider an international response to climate change.

The UN Framework Convention (1992) and the Kyoto Protocol (1997)

Following a series of scientific and governmentally organized conferences between 1985 and 1990, the United Nations General Assembly decided in 1990 to create an Intergovernmental Negotiating Committee for the development of a climate convention – to be open for signature on the occasion of the 1992 UN Conference on Environment and Development.

The FCCC entered into force on 21 April 1994 and has been ratified by 186 countries (as of 7 September 2000). Its major objective is to 'prevent dangerous anthropogenic interference with the climate system' (UNFCCC, 1994: Article 2) while acknowledging the preferences of developing countries for economic and sustainable development. It also encourages industrialized countries to return their GHG emission to 1990 levels by the year 2000 (UNFCCC, 1994: Article 4 (2)) while developing countries mostly have to abide by reporting requirements.

In order to reach the objective of the FCCC, most scientists suggest that substantial emission reductions of GHGs are required. Following three years of intensive negotiations, the third conference of the parties (COP-3) concluded the 'Kyoto Protocol to the United Nations Framework Convention on Climate Change' in 1997. Its main provision asks industrialized countries to reduce their weighted yearly GHGs by 5.2 per cent in the period 2008–12 relative to 1990 levels. A variety of market-oriented instruments have been created to reach such emission reductions. The Kyoto Protocol (1997), signed by eighty-four countries (as of 27 November 2000), left substantial 'unfinished business' and COP-4 at Buenos Aires in 1998 only agreed on a work-plan to resolve such matters – for example, the rules governing the operation of the market-oriented mechanisms – until the year 2000. This deadline was clearly missed and the Kyoto Protocol has not yet entered into force.

Major controversies

Following the second assessment report of the IPCC in 1995, it has been mostly accepted that humans interfere with the climate system. Such agreement has yet to be reached on ways to conclusively limit the expected adverse effects of climate change. Several debates impinge on each other. Three controversies receive major attention, namely (1) the obligations of developing countries, (2) the role of market-oriented instruments for emission reductions and (3) the role of equity or fairness.

First, the United States and other countries would like developing countries to commit to emission reductions, for example, relative to a projected emission path. By asking for 'voluntary commitments' or 'meaningful participation' by major developing countries, the United States responds to domestic pressures related to the ratification of the Kyoto Protocol. By contrast, developing countries have insisted that their overriding priority is economic development and eradication of poverty. Furthermore, they stress the historical obligations which industrialized countries have for their emissions, previously released and partially still active due to the varying residence times of GHGs. The matter is complicated by the expectation that the group of present-day developing countries will account for more than 50 per cent of GHG releases by the middle of the twenty-first century. By the fourth conference of the parties (COP-4) at Buenos Aires in 1998, differentiation among developing countries surfaced: Argentina and Kazakhstan are exploring ways to assume obligations under the climate-change regime which include emissions reductions, either in absolute terms or relative to the expected emission path. These moves may have catalytic effects on other countries currently resisting such obligations. In order to avoid compensating the emissions reductions of some countries by increases in others, it will be necessary to cover the emission policies of all major GHG emitters in the longer term.

Second, some observers suggest that the climate-change regime has turned into an economic regime. This may be due to the attention given to the market-oriented (or 'Kyoto') mechanisms created by the Kyoto Protocol. These include the creation of bubbles (countries 'unite' for the purpose of honouring a joint emission goal), emissions trading among industrialized countries (one country sells surplus emission permits to another in exchange for, for example, financial assets), undertaking joint implementation (JI; industrialized countries invest in GHG reductions in another industrialized country and receive 'credits' toward their national emission target)

and the clean-development mechanism (CDM; industrialized countries invest in GHG reductions in a developing country and receive 'credits'). It should be noted that CDM is JI with a sustainable-development component and a surcharge to be used for adaptation measures in developing countries.

The United States and other market-oriented countries, as the primary force behind the Kyoto mechanisms, wish to minimize abatement costs, whereas the EUROPEAN UNION (EU) wants to limit the use of such instruments, in particular in order to limit the amount of trade in otherwise unused emission rights. In combination, the Kyoto mechanisms may create a market in carbon permits (emissions in other GHGs can be easily converted into carbon equivalents) and lower global abatement costs - an innovation in the history of global environmental policy with no present-day counterpart in other global environmental agreements. A range of developing countries have shown increasing interest in the development of the CDM and COP-4 decided to prioritize it over other Kyoto mechanisms. The development of the rules governing the precise operation of the Kyoto mechanisms was scheduled to be completed by the year 2000 but ran into serious difficulties at the Hague Conference. Nearly all relevant specialized agencies within the UNITED NATIONS (UN) system have entered the discussion; for example, the WORLD BANK created, inter alia, the National Strategy Studies Program and the Global Carbon Initiative.

Third, equity or JUSTICE serves as a major underlying theme of the climate negotiations. At the core of the debate between developing and industrialized countries is the allocation of the rights to emit GHGs. Most often voiced has been the per capita distribution which would reflect the equal rights of all humans and benefits countries with large populations. As industrialized countries currently often emit large multiples of developing country per capita emissions, 'contraction and convergence' may offer a way to achieve equitable distribution of pollution rights. Distributing emission rights universally would also imply

obligations for developing countries in terms of maximum allowable emissions, as discussed above.

Preventing dangerous interference with the climate system remains the overarching goal of the FCCC. To operationalize and achieve this goal remains a major challenge for scientists and policy-makers. Present knowledge suggests that current obligations under the FCCC and Kyoto Protocol will be insufficient to achieve this goal. To create a regime which reduces environmental vulnerability while being cost-effective and acceptable to major developing countries on equity grounds will be the challenge for global climate diplomacy.

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DETLEF F. SPRINZ

globalization

Globalization ranks as one of the core concepts of social consciousness and analysis in the late twentieth century. With striking rapidity, since the 1980s the term has become standard vocabulary for journalists, politicians, business-people, advertisers, entertainers and officials, as well as researchers across a wide spectrum of academic disciplines. Variants of a globalization concept have also appeared during this period in dozens of languages besides English: for example, *toan kou hoa* in Vietnamese, *mondializare* in Romanian, *globalización* in Spanish and so on. Very large numbers of people have staked substantial parts of their fortunes, careers, convictions and identities on the idea that contemporary history is yielding a new globalized world.

However, like many a buzzword, 'globalization' is highly elusive and deeply contested. The controversies usually centre on questions of general definition, periodization, causation and consequences. The following article treats these (in many ways interrelated) issues in turn.

General definition

Although the noun 'globalization' appeared in a dictionary (of American English) for the first time in 1961, the idea has antecedents that stretch back at least several centuries. For example, conceptions of the terrestrial world as a single place can be found in Shakespeare. In the eighteenth century, a number of London-based transatlantic traders regarded themselves as 'world citizens'. At the end of the nineteenth century, English-speakers began to use the adjective 'global' to designate 'the whole world' in addition to its earlier meaning of 'spherical'. The terms 'globalize' and 'globalism' were introduced in a treatise published in 1944. However, until the last decades of the twentieth century such terminology generally resided at the margins of speech and meaning. Thus, as a popular catchphrase, the history of 'globalization' is quite short.

When a new word gains currency, it is often

because it captures an important change that is taking place in the world. New vocabulary is needed to describe new conditions. In the case of globalization, the precise character of that new circumstance is much debated. Three broad kinds of definition might be distinguished, although it should be noted that many commentators slide between these different meanings. The third formulation is given more extended attention below, as it provides the most distinctive insight.

One common approach regards globalization as merely an extension of INTERNATIONALIZATION and a further intensification of international INTERDEPENDENCE. Indeed, many people (and, among academics, economists in particular) are prone to employ the terms 'globalization' and 'internationalization' interchangeably. However, when conceived along these lines the new word adds nothing particularly distinctive and would require no separate entry in this encyclopedia.

In a second general usage, 'globalization' is taken to designate the emergence of a single worldwide society: the GLOBAL SOCIETY. From this perspective, globalization refers to a process of planetary integration. Such a development is often presumed to entail: (1) a shift from national to cosmopolitan loyalties, (2) the creation of a world central government in place of the INTERSTATE SYSTEM and/or (3) a worldwide homogenization of cultures. In this vein, globalization is frequently associated with a universalization of what is variously called 'Western', 'modern' or 'American' civilization. Conceptions of this second kind have with good reason been criticized as simplistic and (when advanced by persons of a liberal-cosmopolitan disposition) idealistic.

A third broad notion of 'globalization' highlights a transformation of world geography that occurs when a host of social conditions become less tied to TERRITORIALITY. Along such lines I have identified globalization (Scholte, 1997) as a trend whereby social relations acquire relatively distanceless and borderless qualities, so that human lives are increasingly played out in the world as a single place. In this conception 'global' phenomena

extend across widely dispersed terrestrial locations at the same time and can move between places scattered worldwide in no time. Globalization thus entails the appearance and multiplication of connections involving world-scale simultaneity and instantaneity. While the patterns of 'international' interdependence are strongly influenced by territorial distances and nation-state divisions, patterns of 'global' interlinkages often have little correspondence to distance and boundaries. In this sense globality involves what might be called 'supra-territorial', 'transborder' or 'transworld' space. The latter three terms will be employed as synonyms for 'global' in the rest of this article.

Illustration should help to clarify this third, most distinctive and most revealing conception of globalization. The rise of supraterritoriality has been manifested across large areas of contemporary social life, including forms of communication, organization, production, marketing, finance, ecology and consciousness. Hence this shift in the contours of geography has extended quite comprehensively across social life.

With regard to communication, for example, globalization has occurred through the advent and spread of air travel, liquid-fuel rocketry, telegraphy, telephony, facsimile, computer networks, radio, television and electronic newspapers. Such links permit persons anywhere on earth to have nearly immediate contact with each other, irrespective of the territorial distance and state borders that might lie between them. An e-mail message or satellite broadcast can travel between continents as quickly as across town.

In terms of organizations, globalization has unfolded through the proliferation and expansion of companies, associations and regulatory agencies that operate as transborder networks. Bodies such as Nestlé S.A., Greenpeace and the WORLD TRADE ORGANIZATION (WTO) coordinate their activities on a worldwide basis, with only limited interference from distance and borders. Global business organization has furthermore taken the form of inter-firm alliances (see ALLIANCES, INTER-FIRM), by which companies team up in transborder

collaboration without effecting a full-scale merger, for example, through subcontracting arrangements or JOINT VENTURES. The possibilities of global organization have also prompted thousands of corporations to establish offshore positions to minimize the impact of unwanted taxation and regulation. Owing to transworld connections, the particular territorial location of an offshore centre often has little significance.

Globalization has also occurred through the appearance and multiplication of transborder production processes (see TRANSNATIONALLY INTEGRATED PRODUCTION). In these situations different phases of production are spread across and coordinated between a number of countries. Global production and associated intra-firm trade has become especially prevalent in the manufacture of motor vehicles, consumer electronics, textiles, sports articles, toys, optical goods, semiconductors and construction equipment. In these instances, the product is made not within a country unit, but in a transborder space.

Meanwhile, the globalization of markets has developed when certain products are distributed and sold across any number of countries, irrespective of the distances and borders that might lie between the various sales points. In this way consumers dispersed across the world purchase the same brand-name good or service at the same time. The large range of global products has come to include scores of foods (for example, Kellogg's cereals), beverages (for example, Heineken beer), cigarettes (for example, Marlboro), clothes (for example, Levis), household articles and appliances (for example, Palmolive soap), pharmaceuticals (for example, Bayer aspirin), music recordings (by, for example, Pavarotti), audio-visual productions (for example, Disney films), printed publications (for example, this encyclopedia), on-line information services (for example, CompuServe), office and hospital equipment (for example, Xerox photocopiers), armaments (for example, AK-47 rifles), transport vehicles (for example, Boeing jets) and travel services (for example, Hilton Hotel rooms). Global products have come to figure in the everyday

lives of most of humanity, whether through actual purchases or, in the case of poverty-stricken millions, in unfulfilled desires evoked by global advertising.

In the area of finance, globalization has been manifested in certain money forms, banking activities, securities markets and DERIVATIVES trading. Territorial money prevails when each country has a single, national currency under state monopoly control. By contrast, globalization has seen the development of supraterritorial monies. For example, various national currencies like the 'German' mark and the 'Japanese' yen have gained transborder circulation. In addition, several distinctly global money forms like SPECIAL DRAWING RIGHTS (SDRs) and Visa credit cards enjoy transworld recognition. Global banking has arisen especially through the EUROCURRENCY MARKET, where deposits and loans denominated in a given national money are handled outside that currency's country of origin. Instantaneous transborder electronic fund transfers have further delinked banking from territorial space (see also SWIFT). Global securities markets have grown with the proliferation of euro-bonds, multinational listings of various equities and interlinkage of stock exchanges in round-the-clock, round-the-world share dealing. Similar transworld trading has developed in respect of financial derivatives. For example, the same futures contract might be handled simultaneously on the Chicago, Singapore and London markets. In all of the activities just described, finance operates through global pools of funds that move across the world with little heed of distance or borders.

Ecologically, globalization has taken place through such phenomena as planetary climate change (or 'global warming'), atmospheric ozone depletion, the prospective worldwide exhaustion of certain natural resources and a decline in Earth's biodiversity. None of these environmental developments can be isolated in one or another country, nor does distance offer an escape route. Global ecological problems have arisen in, and affect, the world as a single place.

Finally, in this brief survey of the many manifestations of globalization, the growth of

supraterritorial space is seen in the ways that people conceive of their social context. The terrestrial world is increasingly regarded not only as a collection of many separate places (districts, countries, regions and so on), but also as a single place: 'the globe'. Instead of holding microcosmic conceptions, where one's 'world' does not extend beyond the village, countless people have acquired macrocosmic notions, where the world itself is a village. Global consciousness has also developed as certain languages (especially English), narratives (for example, James Bond films), icons (for example, the Coca-Cola logo) and other symbols have gained transborder circulation. Ideas of the world as a single place have also been encouraged through events like global sports competitions, global trade fairs, global conferences like the Rio Earth Summit and global tours by entertainment superstars.

The above seven dimensions of globalization often overlap and have many mutually reinforcing effects. Thus, for example, global production and marketing have frequently contributed to global ecological degradation, which has in turn fed global consciousness, which has in turn encouraged the creation of relevant global regulatory organizations, which have in turn often exploited the potentials of global finance and global communications, and so on. Together, the many – substantially interrelated – developments described above have created large areas of social life that cannot be reduced to a territorial logic of places, distances and borders.

It is important to emphasize a number of qualifications in respect of the definition of globalization just outlined. Such a conception does *not* necessarily imply:

- that globalization is wholly new to the late twentieth century;
- that globalization has spread universally;
- that globalization has touched everyone to the same extent;
- that globalization has affected everyone in the same way;
- that globalization is eliminating cultural diversity;

globalization

- that globalization contradicts and has been reducing national attachments;
- that globalization heralds the demise of the state;
- that globalization means the end of territorial space; or
- that globalization was inevitable and has become irreversible.

Many commentators have advanced one or several of these corollaries, but none of these claims is integral to the third type of definition. On the contrary, some powerful arguments can be raised against each of these assertions about globalization.

Periodization

As with any question of historical beginnings, it is difficult to assign a precise date to the onset of globalization or to identify an exact moment when supraterritoriality became significant. Many observers presume that globalization is new to the last decades of the twentieth century. In contrast, some critics argue that the new concept describes an age-old condition. Alternatively, contemporary globalization can be seen to involve an interplay of long-term trends and short-term shifts.

Accounts of globalization tend to adopt one of four general positions in respect of its origins. Some perspectives suggest that globality has existed throughout recorded human history. Other conceptions make globalization roughly concurrent with the history of modernization, say, from the fifteenth century. A third chronology dates the beginnings of globalization from the second half of the nineteenth century. However, most commentators locate its start somewhere between the 1950s and the 1980s.

The first two time-frames are only sustainable if 'global' is equated with 'long-distance' and 'international'. Transoceanic and cross-continental movements of migrants, merchandise, money and credit can be traced back several thousand years. However, such connections lacked the quality of supraterritoriality distinguished above: they could not simulta-

neously and instantaneously link locations anywhere on earth. Distance and (especially after the sixteenth century) territorial borders were major determinants of the possibility, frequency, intensity and significance of earlier world-scale activity. The only evidence of globality (in the sense of supraterritoriality) in these times, lay in the speculations of a few minds that from the fifteenth century onwards contemplated the possibility of transborder government, instant transworld communication and so on.

More tangible and sustained manifestations of globalization began to multiply from around the middle of the nineteenth century. One major writer on the subject, Roland Robertson (1992), has called the ensuing decades the 'take-off' period of globalization. These years saw the invention of such global communications technologies as the telegraph, telephone, facsimile and aeroplane. Transworld telegraph cables were laid in the second half of the nineteenth century and a number of world service radio broadcasts were initiated in the 1920s. Permanently established transborder bank networks developed from the 1830s, while overseas plants of manufacturing enterprises appeared from the 1850s. Transborder peace, labour, anarchist and women's movements also became active in the late nineteenth century, as did the first regulatory agencies with a world-wide remit, like the INTERNATIONAL TELEGRAPH UNION (ITU) (now the INTERNATIONAL TELECOMMUNICATIONS UNION) in 1865 and the General Postal Union (now the Universal Postal Union) in 1874. A few products like Singer Sewing Machines and Heinz tinned foods began to acquire global markets in the late nineteenth century and, by 1929, Coca-Cola was bottled in twenty-seven countries and sold in seventy-eight lands. The gold-sterling standard which prevailed *circa* 1870–1914 gave certain monies worldwide circulation and facilitated a proliferation of foreign stock quotations and foreign bond issues. The first transborder initiatives at wildlife conservation were taken around the turn of the century. All of these developments encouraged, and were encouraged by, further growth of global con-

sciousness. The late nineteenth century saw the birth of round-the-world tourism, world fairs, the modern Olympic Games and other global events.

However, we should not exaggerate the extent and significance of these forerunners of contemporary globalization. Before the 1950s, supraterritorial relations emerged for the most part slowly, among small and restricted circles of people, and usually at the margins of everyday experience. Transborder organizations of the nineteenth century were comparatively small in number and size and lacked the generally much tighter transworld coordination of operations witnessed a hundred years later. Even in 1950, the vast majority of the world's population never received telegrams or telephone calls, never heard radio or watched television and never boarded an aeroplane. Meanwhile other dimensions of global space such as computers, offshore centres and transborder ecological degradation were glimpsed barely if at all before 1960.

The main spread and acceleration of globalization therefore occurred from the late 1950s onwards. Commercial jets, satellites and inter-continental missiles all arrived on the scene at this time. The first transoceanic telephone cable was laid in 1956 and transborder direct dialling first became available in 1963. Radio and television receivers became household items the world over mainly after 1960, while the forerunner of the internet was set up in 1969. Transborder companies proliferated from 3,500 in 1960 to 40,000 in 1995. Some 90 per cent of the 15,000 transborder civic associations counted in the mid-1990s were founded during the preceding thirty years. Similarly, global GOVERNANCE agencies (more commonly known as INTERNATIONAL ORGANIZATIONS (IOs)) multiplied from 154 in 1960 to 1,763 in 1995. Transborder production processes and associated intra-firm trade were practically unknown before the 1940s and most global products gained their transborder markets from the 1960s onwards. In the area of finance, the first EURODOLLAR deposits appeared in the early 1950s, the first eurocurrency loan in 1957, the first eurobond in 1963, the first financial

derivatives in 1972 and the first transborder electronic link between stock exchanges in 1985. Major global ecological issues like climate change, holes in the ozone layer and losses of biodiversity reached the agenda after 1970. Global consciousness also acquired unprecedented prominence after the mid-twentieth century, gaining perhaps its single greatest boost by the worldwide publication in 1966 of pictures taken from outer space showing the earth as a single place.

As previously emphasized, this major spread and acceleration of globalization in the second half of the twentieth century did not herald a complete end to territorial geography, nor a dissolution of the state, nor a demise of national loyalties. Indeed, the expansion of supraterritorial space may never have such consequences. The future might even bring a reversal of globalization and a return to a more territorialized world. However, at the time of writing most signs suggest that globalization is likely to proceed considerably further.

Causation

Having outlined different definitions of globalization and several arguments concerning its chronology, we come to the still more challenging question of causation: why and through what dynamics has the process occurred? Most accounts of globalization give this tantalizing issue only passing attention or avoid it altogether. On the minority of occasions when the question is more fully addressed, authors tend to highlight one or several of the following four general driving forces: technological change, state policy, capitalism and secular rationalism.

Explanations that regard globalization as an outcome of technological change stress the importance of extensive innovations in respect of transport, telecommunications, informatics, electronic mass media and so on. Such accounts note that extensions of mechanization – in terms of air travel, telephones, computers, satellites, fibre-optic cables and the like – have often been indispensable to the transcendence of territorial geography. Processes of ever-expanding automation have perhaps, with time,

also acquired a certain momentum of their own, helping to propel globalization further. However, arguments of technological determinism do not explain why these innovations should have been pursued at all.

Other researchers have highlighted state policies as a primary engine of globalization. These accounts stress, for example, that state actions created the intergovernmental organizations that have developed into global governance agencies. Likewise, state decisions have relaxed foreign exchange controls, established offshore centres and otherwise spurred the growth of global finance. Conversely, states have inhibited globalization when they impose restrictions on transborder travel, trade and investment, the purchase of satellite dishes and internet software, and so on. Perhaps a great deal of globalization would not have unfolded – or occurred so quickly – had state policies not facilitated the process. However, a fuller explanation must also consider the forces that prompted – indeed, perhaps forced – states to take those enabling steps.

A third type of explanation of globalization draws on Marxist political economy and regards the trend as a phase of capitalist development. MARX himself anticipated the growth of supraterritorial relations when he wrote in *Grundrisse* (1857–8) that ‘capital by its nature drives beyond every spatial barrier’ to ‘conquer the whole earth for its market’. Other commentators have suggested that capitalism has promoted globalization as a way to break the constraining hold of the post-1945 corporatist compromise and to reverse a FALLING RATE OF PROFIT (FRP). The growth of transborder capitalism has indeed, especially since 1980, put many downward pressures on wages, corporate taxation, business regulation and social security expenditure. At the same time, a number of capitalist ventures have needed the economies of scale provided by global markets to achieve profitability. In addition, various tools of globalization (like telecommunications and new information technologies) have created major channels of surplus accumulation in their own right.

Compelling though this logic may seem, a crude Marxist argument cannot answer every question. For one thing, ‘going global’ has in practice hurt many corporate balance sheets. The decades of accelerated globalization have also seen prolonged recession, debt crises and recurrent huge losses on securities and derivatives markets (see DEBT CRISIS). Moreover, state policies, nationalist sentiments and religious revivalism have often defied forces of globalizing capital. It is also simplistic to explain global ecological problems and the rise of global consciousness wholly and solely as a function of capitalist development. In any case, a deeper exploration should ask why capitalism has such power in the first place.

A fourth approach points to techno-scientific rationalism as the primary engine of globalization. In this perspective, the rise of supraterritoriality is understood as a product of human striving after the transcendent and the whole. In pre-modern ‘religious’ cultures, these impulses focused on knowing God (or the gods). Thus such ‘maps’ of ‘the world’ as existed at this time generally depicted relations between humanity and deity. With the rise of secularism – so this argument goes – pursuit of the transcendent was reborn in the guise of global visions. Hence, for example, modern ‘objective’ science was purportedly true for anyone anywhere, while the cosmopolitan universalism of the enlightenment reconstructed the end of history in terms of a worldwide human community. According to this account, modern rationalism has also propelled globalization in so far as distance and borders often stand in the way of achieving utilitarian efficiency and a mastery of nature. Like the previous three arguments, this fourth line of explanation offers some compelling insight, but on its own it too seems oversimplistic.

Perhaps the four above explanations are most convincing in combination. From this perspective, globalization would be understood as an outcome of cumulative and mutually reinforcing impulses of various technological innovations, certain outcomes of the states-system, several attributes of advanced capitalism and particular aspects of rationalism. The growth of global relations has then resulted from certain

potentialities in MODERNITY. Globalization was not historically inevitable, but modern structures of automation, the state, capitalism and rationalism made it possible.

Consequences

Many debates over globalization concern its repercussions. Among other things, globalization has been said to prompt the collapse of socialism, the onset of DISORGANIZED CAPITALISM, the development of POST-INDUSTRIALISM, the growth of religious resurgence, the eclipse of the nation, the demise of the state, 'the end of geography' and even 'the end of history'. At the risk of oversimplification, assessments of globalization's consequences might be summarized through a six-fold typology of realism, traditionalism, neo-liberalism, Keynesianism, critical theory and post-modernism.

Analysts of a political realist persuasion (see REALISM) dismiss talk of globalization as 'hype' and 'myth'. In their view globalization has (in so far as such a process has unfolded at all) produced little if any transformation in the world political economy. For them, an age-old logic of international anarchy and power struggles between sovereign states is persisting unchanged into the twenty-first century. Political realists provide welcome caution against those 'globalists' whose exuberance and historical myopia leads them to exaggerate the rate and extent of change. However, these sceptics also stubbornly ignore the ever-expanding evidence of a systemic shift away from the territorialized world of the modern states-system. Their entrenched prejudices prevent them from contemplating even the possibility that globalization and far-reaching change could take place.

'Traditionalist' assessments of globalization encompass various strands of religious resurgence, ethnic revivalism, nationalism, nostalgic localism, deep ecology and so on. Contrary to realists, traditionalists acknowledge that the geography of distance and borders is in retreat – and oppose the trend. For them, globalization threatens established faiths and identities, cultural diversity, local and national self-

determination, ecological integrity and other treasured aspects of territorial spaces. These conservatives would like to reverse globalization and retrieve a pre-existent and perhaps even pre-modern condition. Although their worries have some foundation, many are exaggerated and one can question their prescriptions. Traditionalists would undo the fruits as well as the problems of globalization, and their images of 'tradition' are often romanticized.

In contrast, neo-liberals can find little if any fault with globalization (see NEO-LIBERALISM). For a host of politicians, neo-classical economists, management consultants and others, the advent of a borderless world has automatic consequences of prosperity, democracy, peace and liberty for all. In neo-liberal eyes, globalization marks a further advance – perhaps even the final victory – of modernity over poverty, ignorance, drudgery, war and authoritarianism. The invisible hand of a global market is yielding unprecedented levels of human freedom. Critics dismiss neo-liberal celebrations as premature and simplistically optimistic. These accounts usually exaggerate both the extent of globalization and the degree of attendant social change. Moreover, neo-liberals tend to ignore substantial evidence that connects globalization with persistent destitution, growing material inequalities, deepening ecological degradation, increased intra-state warfare and widespread losses of democratic control. Indeed, harsher critics charge (on neo-Gramscian lines – see NEO-GRAMSCIANISM) that neo-liberalism has served ruling elites as an IDEOLOGY that obscures the widespread suffering that globalization has actually induced.

Keynesian evaluations of globalization share the general liberal faith that an emergent global economy can fulfil many modern hopes of social progress. However, Keynesians argue, against neo-liberals, that this promise cannot be realized through market forces alone (see KEYNESIAN ECONOMICS). Indeed, these social democrats worry about evidence that globalization has often enlarged inequalities, raised unemployment, worsened working conditions,

deepened poverty in parts of the SOUTH, heightened environmental damage and increased OLIGOPOLY. In response, Keynesians have suggested – and to a limited degree implemented – a host of institutional and legal reforms. Among other things, they have advocated debt relief, greater regulation of global financial markets, global competition policy, global taxation schemes, the inclusion of social clauses in STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs) and the judgements of the World Trade Organization, and so on. Although many have welcomed Keynesian antidotes to neo-liberalism, more radical critics charge that the prescribed reforms do not go nearly far enough.

Some of these deeper critiques broadly follow the precepts of CRITICAL THEORY and socialist practice. Like neo-liberals and Keynesians, they endorse the general enlightenment project of maximizing human potential through the application of reason. However, these critics doubt whether the orthodox formula of capitalist markets, liberal democracy and national self-determination can provide full-scale emancipation in a globalizing world. For critical theorists and associated activists in anti-systemic movements, globalization has emphasized the flaws of mainstream liberalism more clearly than ever. They variously highlight a purported bankruptcy of territorial multiparty politics, the moral emptiness of global consumerism, structural violence within global capitalism along lines of class, RACE and GENDER, and the absence of viable structures of community in the globalizing world. In contrast to reactionary traditionalism, socialists look to harness opportunities that globalization provides for creative reconstructions of democratic politics. Yet these assessments can be criticized, too. They often overestimate the extent of globalization, fail adequately to elaborate alternatives to the classical liberal formula and underestimate the difficulties involved in effecting radical social transformation.

Dividing lines between critical theory and a sixth general assessment of the consequences of globalization, POST-MODERNISM, are not al-

ways clear-cut. However, the latter approach has certain distinguishing features. For example, in contrast to critical theorists, post-modernists harbour fundamental misgivings about the enlightenment project. In particular, they doubt the merits of rationalist thought and decry the cultural and psychological violence that has transpired when forces of modernity have marginalized, subordinated and silenced different, non-modern and perhaps openly anti-modern voices. For post-modernists, modern international relations have – by means of territorial borders, state sovereignty, rationalist foreign-policy calculations and exclusivist national identities – perpetrated some of history's greatest oppressions. Post-modernists vehemently denounce globalization when the process has tended to destroy cultures and universalize modern structures. Yet they also celebrate globalization in so far as the growth of transworld relations offers opportunities to loosen the strangleholds of territoriality and modernity and to foster new pluralisms, particularly of identity and knowledge. Like socialist critical theorists, post-modernists frequently overestimate the extent of globalization and the degree to which it has weakened the state and nationalism. Their general tendency to underplay the importance of capitalist forces and issues of material welfare has also attracted criticism. Finally, post-modernists often assume rather blithely that alternative non-rationalist global politics will produce greater democracy, creativity and peace. However, careless experiments in post-modern constructions could well unleash new violences, perhaps with even greater intensity than those perpetrated in the name of scientific reason.

Conclusion

The preceding review of debates concerning the general definition, periodization, causation and consequences of globalization has, perforce, only skirted the many significant issues implicated in this historical development. As the many cross-references marked above suggest, the rise of supraterritoriality lies at the heart of

many, if not most, of the key questions of contemporary IPE. For some, globalization even raises the possibility that the designation *international* political economy has become obsolete.

See also:

global society; governance, global; internationalization; territoriality

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JAN AART SCHOLTE

gold exchange standard

The gold exchange standard is one of several possible international monetary arrangements involving gold. As a basis of comparison, Yeager (1976) notes that under a gold coin standard, all other kinds of money are convertible on demand into gold coin. The actual circulation of gold coins, together with at least short-run stability in the public's preferred ratio of gold coins to other types of money held, is supposed to provide a fairly stable and not too highly geared connection between a country's monetary gold stock and its total money supply. One advantage claimed for the system is that the threat of drains on their gold reserves will restrain the government and central and commercial banks from following

inflationary policies. They must take care not to alarm people in the street who, by demanding or not demanding redemption of their money in gold coins, can exercise control over financial policies.

Under a gold bullion standard, the authorities stand ready to buy and sell uncoined gold at a fixed price, but only in large minimum amounts. The absence of gold coins from circulation and the obstacle this poses to redemption and gold hoarding by the ordinary citizen permit further 'economies' in the use of gold, that is, a smaller and probably more flexible gold reserve ratio.

A gold exchange standard permits still further 'economies'. The monetary authority of a country ties its currency to gold not directly but by dealing on the foreign exchange market to maintain a substantially fixed exchange rate with some foreign currency that is on a gold coin or gold bullion standard. The national authority holds its reserves as bank deposits and other liquid claims in the foreign currency. The opportunity to earn interest is one reason for holding reserves in this form, rather than in actual gold. The gold reserves of the country on the actual gold standard – the so-called centre country – do double duty: they 'back up' its own currency directly and the currencies of one or more members of the system at one remove. The total money supplies of the member countries are pyramided onto a smaller and presumably more variable percentage of actual gold than would prevail if each held its own gold reserve. Still, the authorities of each country must pay attention to the relative sizes of their monetary liabilities and their foreign exchange reserve so they can keep domestic money redeemable *de facto* in foreign exchange.

A foreign exchange standard need not be a gold exchange standard: the foreign money held as reserves and to which the home currency is pegged need not be at a gold standard currency. One notable example was the system maintained by members of the STERLING AREA during the 1930s when the British pound was not linked to gold. As long as a country is anxious to keep its exchange

rate fixed, maintain an adequate reserve of foreign exchange in relation to its domestic money supply, and allow gains and losses of foreign exchange to expand and contract, it limits its monetary independence in the same general way as it would under an actual gold standard.

Intermediate positions are conceivable between being on a gold standard and being on an exchange standard. The national monetary authority might hold its reserves partly in gold and partly in foreign currencies tied to gold, and deal on the foreign exchange market to keep the exchange rate so close to par that private gold arbitrageurs would seldom if ever find it worthwhile to operate. Even if the authority stood ready to buy and sell actual gold at a fixed price, it might seldom be called on to do so.

There is no clear-cut line between being on or off a gold or exchange standard. International monetary linkage is a matter of degree, to be judged by how large or small and how variable the ratio is between a country's gold or foreign exchange reserves and its domestic money supply, and by how closely the money supply responds to the balance of payments. The linkage is largely window-dressing if FIXED EXCHANGE RATES are maintained by controls over import and other expenditures abroad, and if the money supply is insulated from balance of payments developments.

At the opposite extreme from the 100 per cent gold standard stands complete national monetary independence. Each country's money then has its total supply determined solely by domestic considerations, is not pegged to or backed by or redeemable in gold or anything else, and has its rates of exchange against foreign currencies determined by the free play of private supply and demand.

To summarize, the gold exchange standard evolved from the gold standard but differs from it most basically in that its operational international reserves consist of both gold and convertible national currencies. Consequently, the world's payment mechanism can function properly with a smaller quantity of gold than

under the gold standard, thus economizing on the use of the precious metal.

The workings of the gold exchange standard can be best illustrated through a simple model developed by Grubel (1981), in which one country is designated as the 'reserve country' and the rest are 'non-reserve'. All countries are assumed to have fixed exchange rates and independent monetary and fiscal systems, and thus they have the need to hold international reserves for the settlement of payment imbalances. If the countries then decide to shift from the gold standard to a gold exchange standard, the following rules would have to be adopted:

- 1 All gold held by the non-reserve countries is turned over to the reserve country.
- 2 The reserve country issues to the non-reserve countries its own currency obligations, such as dollars, in return for the gold, and commits itself to hold only gold as reserves. The reserve country's dollar obligations are convertible into gold on demand and pay a low interest to the bearer.
- 3 The national non-reserve governments agree to accept these dollar obligations as a means of payment as they had previously accepted gold.
- 4 It is agreed that the reserve country can issue dollar obligations in excess of its gold stock as long as it maintains a minimum ratio of dollars to gold.
- 5 All newly mined gold not needed for industrial purposes is turned over to the reserve country at a predetermined fixed price.

In this simplified model it was assumed that the non-reserve countries held only the reserve country's (in this example, dollar) obligations. It is easy to modify the model by considering the possibility that non-reserve countries wish to maintain a certain fraction of their international assets in the form of gold. If this is so, two major consequences follow. First, the degree of gold economizing inherent in the gold exchange standard is smaller than it otherwise would be. Second, unless the non-reserve countries agree firmly to maintain a

fixed ratio of gold to dollars, the system becomes unstable whenever the reserve country's solvency becomes suspect. Non-reserve countries then begin to convert their dollar holdings into gold and produce what is equivalent to a run on the bank.

The model outlined above is an idealization of the basic idea of how the world could economize on the existing stock of gold. However, between this theoretical ideal and the real world, there have been great differences over time in the actual operations of the various gold exchange standards.

In the pre-World War I era, even during the heyday of the gold standard, some central banks held national currencies as international reserves. In 1884, Russia began to hold some of its reserves in Berlin and other financial centres. In 1885, the central banks of Denmark, Norway and Sweden were authorized to hold balances with each other and to count these balances as reserves on which the issue of notes was based. In 1913, fifteen European central banks together held about 12 per cent of their total reserves in the form of foreign exchange.

In the 1920s, most of the countries in the world adopted legislation permitting their central banks to hold gold and foreign exchange assets exchangeable into gold, some without and some with limitations on the fractions of reserves that had to consist of gold. Unfortunately, the form of the gold exchange standard existing at this time suffered from a number of fatal flaws. These included the use of two reserve currencies (the pound and the dollar), the absence of leadership by a hegemonic power, the failure of cooperation between the key members (England, France and the United States) and the unwillingness of its two strongest members, the United States and France, to follow the rules of the game. Instead they exerted deflationary pressure on the rest of the world by persistent sterilization of balance-of-payment surpluses. This gold exchange standard collapsed in the early 1930s, but not before transmitting deflation and depression around the world.

The gold exchange standard that emerged with the BRETTON WOODS SYSTEM after World

gold standard

War II was another variant (Bordo, 1993) of the gold exchange standard. Here the attempt was to re-establish a system of FIXED EXCHANGE RATES, with gold serving as the primary reserve asset. Gold became an international unit of account when member countries officially agreed to state the par value of their currencies in terms of gold or, alternatively, the gold content of the US dollar. In practice this system was only nominally a gold exchange standard. The idea was to economize on monetary gold stocks as international reserves. This required the United States to assume the role of world banker. The dollar was to become the international monetary system's chief reserve currency. The co-existence of both dollars and gold as international reserve assets led to this system being referred to as the dollar-gold system.

As world banker, the United States assumed responsibility for buying and selling gold at a fixed price to foreign official holders of dollars. Other currencies were pegged to the dollar. As long as the monetary gold stocks of the United States were large relative to outstanding dollar liabilities abroad, the confidence in the dollar as a reserve currency remained intact. Immediately following World War II, the United States' monetary gold stocks peaked at \$24 billion (about two-thirds of the world total). But as time passed, the amount of foreign dollar holdings rose significantly due to US payment deficits. At the same time, the US monetary gold stock dwindled as foreign governments redeemed some of their dollars for gold. By 1965, the total supply of foreign-held dollars exceeded the US stock of monetary gold and the country's ability to honour its gold obligation was questioned.

These circumstances led to speculation that the United States might attempt to solve its gold-shortage problem by devaluing the dollar. By increasing the official price of gold, a dollar devaluation would lead to a rise in the value of the United States' monetary gold stocks. In order to prevent speculative profits arising from any rise in the official price of gold, the United States (along with several other nations) in 1968 established a two-tier gold

system. This involved an official tier, in which central banks could buy and sell gold for monetary purposes at the official price of \$4.35 per ounce, and a private market, in which gold as a commodity could be traded at the free-market price. By separating the official gold market from the private gold market, the two-tier system was a step towards the complete demonetization of gold.

The formulation of the two-tier gold system was a remedy that could only delay the inevitable collapse of the gold exchange standard. By 1971, the United States' stock of monetary gold had declined to \$11 billion, only a fraction of their dollar liabilities to foreign central banks. The US balance-of-payments position was also deteriorating in a dramatic manner. In August 1971, President Nixon announced that the United States was suspending its commitment to buy and sell gold at \$35 per ounce. The closing of the gold window to foreign official holders brought an end to the gold exchange standard, whereby the last functional link between the dollar and monetary gold was severed.

See also:

convertibility, currency; dollar, US; foreign exchange; Great Depression

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ROBERT LOONEY

gold standard

The gold standard began as a domestic monetary order, but its enduring fame is as

the regime that organized international monetary relations in the quarter century before World War I. Between 1880 and 1914, all economically advanced nations (as well as a preponderance of other countries) fixed the values of their currencies in terms of gold. This was a period of unprecedented economic growth and levels of international trade and investment increased steadily until the global economy was highly integrated. Price stability, stable exchange rates and massive capital flows from advanced to developing nations made this something of a golden age in international economic relations.

In stylized terms, the operation of the classical gold standard was simple. Each country (1) fixed the price of its domestic currency in terms of an unchanging weight of gold and (2) allowed free exports and imports of gold. Adherence to the first rule assured fixed exchange rates; indeed, a gold standard is a special case of a fixed exchange-rate system (see FIXED EXCHANGE RATES). Adoption of the second rule, in turn, established a quasi-automatic mechanism of BALANCE OF PAYMENTS adjustment. If a country ran a payments deficit, gold would flow out, as residents converted local currency to meet their obligations abroad. This contraction of the money supply would force domestic prices down relative to world prices, increasing exports and reducing imports, and thus bringing payments back into balance. A number of subsidiary 'rules of the game' ensured that governments allowed the adjustment process to operate.

The actual operation of the gold standard diverged from this stylized view and an expansive literature addresses the degree to which central banks obeyed its rules. Many countries employed measures to limit gold flows and frequently violated the subsidiary rules so as to delay adjustment to changes in external balance. Moreover, advanced nations had a far more favourable experience with the gold standard than did developing countries. Among the advanced economies, the commitment to gold was credible and the adjustment process was stable, so few crises occurred.

Developing countries, by contrast, tended to join the regime when conditions were favourable, but were apt to abandon it whenever conditions deteriorated. Thus, they frequently suffered exchange-rate crises and destabilized growth patterns. The usual explanation for this propensity is that strong domestic political pressures to alter exchange rates often prevailed in developing countries.

Several rationales have been offered to explain why the gold standard was more stable in the developed world. One view – an application of HEGEMONIC STABILITY THEORY – attributes its smooth operation to the stabilizing intervention of the system's dominant member, the United Kingdom. Critics counter that the gold standard was a decentralized multipolar system that was not managed by any one nation. Politically, a key source of stability was the inviolable commitment to gold convertibility in the leading nations; a covenant rooted in the dominance of investor, exporter and trader interests at home. Internationally, this commitment was further buttressed by central bank cooperation in times of crisis.

See also:

'Cross of Gold' speech; foreign exchange; foreign exchange reserves; gold exchange standard

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the origin and maintenance of the gold standard were the products of decentralized or diffuse processes.

J. LAWRENCE BROZ

governance

The problem of governance arises in all social settings when behaviour that is rational from the perspective of individual members of a group leads to collective outcomes that are undesirable or suboptimal for all members of the group. While the range of situations that exhibit these characteristics is broad, a number of paradigmatic cases of such **COLLECTIVE ACTION** problems that stand out (like arms races and trade wars) are properly understood as reaction-process dilemmas. They feature competitive interactions that leave all the participants worse off in the sense that they expend resources without achieving their goals. A second category of problems, like the tragedy of the commons, are marked by unsustainable (and typically inefficient) uses of finite resources. The depletion of living resources through over-harvesting constitutes the classic case in point. Yet a third category of collective-action problems, marked by the phenomenon of free-riding (see **FREE RIDER PROBLEM**), involve situations in which parties refrain from contributing to the supply of **PUBLIC GOODS** or **COLLECTIVE GOODS** in the hope that they can benefit from the willingness of others to supply such goods. Recurrent difficulties in providing adequate funds to operate international regulatory regimes are prominent cases in point.

The classic response to these problems of governance at the domestic level centres on the creation of governments, in the sense of organizations or material entities charged with solving problems of governance in a given social setting and provided with both the authority and the power needed to make collective decisions and to induce the members of the group – whether they are individuals or corporate entities – to implement and comply with those decisions. Whatever the merits of

this solution at lower levels of social organization – and there are numerous concerns about both the effectiveness of governments and the negative externalities associated with governmental activities – it is not a viable option at the international level. In today's world, the members of international society are increasingly constrained by various types of interdependencies. Yet it is abundantly clear that they are not yet willing to turn over sufficient authority and power to a supranational organization to allow it to operate successfully as an international world government. This is not to suggest that the activities of the United Nations are of no significance. Yet it is easy to demonstrate that the United Nations cannot be expected to solve most of the major collective-action problems arising in international society.

Must we conclude from this that there is no solution to the problem of governance at the international level? Not necessarily. One of the most striking developments of the last twenty years in thinking about international affairs is the rise of the concept of governance without government. In essence, this line of thinking focuses on the role of issue-specific institutions or, in the terminology that has become popular, regimes that arise to deal with concrete problems (for example, arms control, trade relations, ozone depletion) in the absence of any larger structure of government. Regimes, in this sense, are sets of rules, decision-making procedures and programmes that serve to define social practices, assign roles to participants in such practices and guide interactions among these actors. Regimes are not actors in their own right. Rather, they are arenas within which actors pursue their goals and they influence the nature of collective outcomes by affecting the behaviour of the actors in these arenas.

The study of international regimes as governance systems, which began as an American enterprise in the 1970s and which has since spread to Europe and beyond, centres on issues of regime formation and regime effectiveness. Why do efforts to form regimes to deal with specific problems succeed in some instances (for example, the establishment of the post-war

regime for international trade) but fail in others (for example, attempts to create arms-control arrangements during the inter-war period)? Efforts to answer this question have produced a number of distinct lines of analysis, which accord varying weight to the roles of power, interests and ideas. While realists and neo-realists (see NEO-REALISM; REALISM) have stressed the importance of leadership on the part of, for example, a single dominant state (that is, a hegemon) or a consortium of powerful states, others have approached this issue as a matter of bargaining or stressed the role of consensual knowledge or unifying discourses in the development of international institutions.

With the growth of regime analysis, attention has shifted increasingly to questions pertaining to the effectiveness of international regimes. How much of the variance in collective outcomes at the international level can we explain in terms of the impact of various regimes? Realists and neo-realists have tended to respond to this question by emphasizing the role of underlying structures of power. Institutionalists, by contrast, regard regimes as autonomous forces that guide actors towards outcomes that would not have occurred in their absence (see INSTITUTIONALISM). Ultimately, this debate turns on the extent and nature of causal connections between institutional arrangements and the behaviour of various actors in international society. Although this debate is far from resolved, it is clear that institutions interact in complex ways with other driving forces and that their importance as determinants of collective outcome varies greatly from one situation to another.

The emergence of issue-specific regimes does not constitute a simple solution to the problem of governance in international society. But coupled with the growth of scepticism about the performance of governments at the domestic level, this movement has sparked a vibrant debate about alternative solutions to the problem of governance in a variety of social settings. The spread of regime analysis to intellectual communities throughout the world is indicative of the importance that many

thoughtful observers now attach to the search for new ways to think about the achievement of governance.

See also:

epistemic communities; neo-liberalism

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ORAN R. YOUNG

governance, global

The increasing complexity of the contemporary world and the advance of GLOBALIZATION have combined to create a growth of interest in global governance – the idea, its prospects and possible forms. The idea of GOVERNANCE itself reflects increasing complexity within the realms of business, economics and politics. Concerns with global governance, in turn, are prompted by the perceived progress of globalization within the political economy, the advance of transnational forms of association – some benign, many malignant – and the emergence of an ever wider range of problems that appear to afflict humanity on a global scale.

Governance indicates the many forms of collective regulation and management that include, but often take place beyond, the formal institutions of established governments. Businesses and their associations undertake extensive regulative activities that are of considerable importance both to their customers,

employees and fellow/member businesses (stock exchanges, self-regulation business associations and so on). Non-governmental agencies often assume regulative authority over areas of life that are of widespread interest (international sports' organizations in particular). In a perverse manner, international criminal organizations that control international flows of illicit drugs are also engaged in a form of governance.

The growing complexity of international life adds a further dimension, and considerable complication, to the issue of governance. Many problems that warrant effective governance now have a global dimension. However, the contemporary fragmentation of the international system into formally sovereign states, complicates and often compromises efforts to create effective structures of governance at this level. There are, moreover, considerable difficulties associated with democratic control within arrangements for governance at the international or global level.

Contemporary global governance is an imperfect mosaic of unilateral, bilateral and multilateral inter-state actions and institutions, and essentially private arrangements between individuals, organizations and business enterprises. The problem with such a complex situation is not only the number of basic requirements of effective global governance that are not properly satisfied, but also that the basic criteria for appropriate global governance remain insufficiently defined.

Governance concerns the authoritative development and maintenance of those arrangements that ensure the provision of valued COLLECTIVE GOODS for any collectivity (that is, collection of affected individuals or organizations). Such collective goods are those desirable conditions that are best provided by collective efforts or indeed can only be provided effectively on such a basis. The rules imposed on members by national stock and share exchanges exemplify such collective goods in the private domain (but with implications for the wider public). PUBLIC GOODS, then, are those collective goods that can best (or only) be provided by the membership of a

multifunction political community or, more particularly, through the formal institutions of government that have been established for or by such a community.

There are many qualities that are characteristic of most (if not definitionally all) collective goods and public goods, most particularly: the inability to exclude any member of the collectivity from the enjoyment of the benefits of a collective (or public) good once it has been provided (*non-excludability*); the inability to divide the 'good' into small quantities that might be consumed on an individual basis (*indivisibility*), and the fact that the enjoyment of the 'good' by one member of the collectivity does not reduce the capacity of others to also enjoy that good to the same extent and in the same manner (*jointedness*). The establishment of an effective nuclear deterrent for a community would constitute a perfect public good for a community through the practical impossibility of excluding any member from the coverage of the deterrent, by entailing equal coverage for all members and by the fact that one member's 'enjoyment' of the deterrent has no negative implications for its 'enjoyment' by other members of the community.

Public goods are thus those communal collective goods that are essential or have been deemed to be essential for the effective functioning of a community and the successful pursuit of its wide range of purposeful activities. The control of negative EXTERNALITIES (such as industrial pollution) or the generation of positive externalities (such as the creation of a highly skilled workforce) are particularly pressing public goods for governments of all types and in all locations. However, public authorities have been able to provide valued public goods not merely because they are intrinsically desirable, but because they have been able to establish and sustain effective mechanisms to overcome the free-riding tendencies (see FREE RIDER PROBLEM) among self-interested individual community members that would otherwise deny sufficient levels of resources for the provision of those desired public goods (Olson, 1965; Frohlich, Oppenheimer and Young, 1971). The

effective provision of public goods at the global level thus requires the development and maintenance of effective mechanisms for the suppression of free-riding tendencies among member-states of the international system and among all other actors who are operative within the global arena: a task that has proven to be formidably difficult both in theory and practice.

The problems of overcoming free rider problems in the provision of global public goods merely compound equally significant problems with the very definition of global public goods themselves. The formal criteria of public goods rarely provide uncontentious criteria for their identification in practice. Indeed, one way of defining politics is as the debate over both the definition and the best means of supply of appropriate public goods. Ultra-liberals would thus identify a very narrow range of legitimate public goods. Political collectivists, in contrast, might argue that there are valuable public goods to be generated across a wide range of human interests and activities. Discussions about contemporary globalization certainly generate specific issues about the range of legitimate (as well as feasible) public goods to pursue at the global level (very narrow within NEO-LIBERALISM; far wider for those concerned about a run-away global financial system and/or growing global environmental dangers).

Debates over the range of appropriate global public goods and feasible mechanisms for their provision do not, however, exhaust the range of problems associated with the idea of global governance. There are also considerable difficulties concerning democracy and global governance. The institutional form of 'global democracy' often causes unnecessary concern. Global democratic institutions do not necessarily need to be composed of directly elected representatives: representatives drawn from democratically elected governments and/or parliaments would still preserve a sufficient level of democratic accountability. The real problem for 'global democracy' is the current reality and future prospects of a global 'community' with a sufficiency of fellow-feeling,

mutual respect and confidence in collective institutions to sustain the 'give-and-take' that is essential to democratic systems if they are to avoid the tyranny of the majority or fragmentation into warring factions. The belief that a minimal level of commonality has to exist among any peoples seeking to build shared democratic institutions poses formidable problems for those aspiring to new arrangements for global democracy – whether that democracy be direct, representative or indirectly representative.

The danger resulting from the fragmentation of current arrangements for international governance and the obstacles facing new institutions of effective public global governance (democratic or not) is the perpetuation and intensification of fragmentation, with private institutions of governance filling many of the gaps created by the weakness of public institutions. Such private forms of governance will, unfortunately, be driven by narrow self-interest, lack the range of resources available to effective governments and, fatally, be denied the popular legitimacy that is ultimately essential to durable arrangements for the provision of public goods. Private global governance is therefore unlikely to prove to be more than a temporary and highly imperfect solution to gaps in effective public global governance. The many problems confronting the establishment of effective structures of public global governance will continue to confront humanity and the public goods required by the 'global community' are likely, in consequence, to be supplied in insufficient quantities.

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R.J. BARRY JONES

Gramsci, Antonio (1891–1937)

Antonio Gramsci was an Italian socialist/communist politician and intellectual. Founding co-editor of the newspaper *Ordine Nuovo* in 1919, which was central in the Turin Factory Council Movement and the foundation of the Italian Communist Party (PCI), Gramsci was also leader of the PCI from 1924 to 1926. A political prisoner from 1926 until his death in Formia Prison Clinic, he was in prison when he wrote his seminal contribution to European communist ideology (see COMMUNISM), Western Marxism and, by extension, the theory of international relations (IR) and international political economy (IPE): *The Prison Notebooks* (1971; 1975).

In *The Prison Notebooks*, Gramsci was preoccupied with the fascist response to the post-World War I capitalist crisis in Italy and the failure of a socialist revolution. This led him to reconsider, through his key concept of HEGEMONY, political strategy and the relationship between economics, politics and emancipation. This also led him to pursue more fundamental philosophical questions on what exactly human emancipation entails, which in turn presupposed deeper reflections on the nature of humanity and of knowledge. He developed a novel interpretation of Marxism (which he called 'philosophy of praxis') that intended to overcome economic DETERMINISM. Contrary to the Marxist orthodoxy of the time, Gramsci emphasized the efficacy of IDEOLOGY and subjective aspects of social life, which he put on par with more narrowly conceived material and economic aspects.

Gramsci's non-determinist Marxism remains a significant source and reference-point for contemporary social theory. Competing interpretations of his thought have informed Althusserian-structuralist (for example, Buci-Glucksmann, 1980), critical-theoretical (Showstack-Sassoon, 1980; Femia, 1981), feminist (Jenson, 1986) and post-modernist works (Laclau and Mouffe, 1985; Golding, 1992) (see STRUCTURALISM; CRITICAL THEORY; FEMINISM; POST-MODERNISM). In the 1980s and 1990s, Gramsci's work gained increased salience in IR and IPE, as its critique of determinism was held to speak to some of the central impasses in the 'third inter-paradigm debate' between NEO-REALISM, NEO-LIBERALISM and NEO-MARXISM.

Gramsci's relevance to IPE is asserted through production- and class-centred critical theory (Pijl, 1989; Gill, 1993; Cox, 1996). From this vantage point, works have been produced that analyse on a global level the relationship between POWER and production, class and STATE, coercive and consensual aspects of global hegemony, and transnational class and CIVIL SOCIETY. For this, they draw especially on Gramsci's argument that subject formation can overflow strict boundaries determined by production and the nation-state.

Gramsci has influenced other works relevant to IPE as well. REGULATION THEORY (especially Lipietz, 1985) has focused on the theme of 'qualitative economics' to analyse the shifts from Fordism to FLEXIBLE ACCUMULATION. Some feminist and post-colonial writings located at the faultlines of critical theory and post-modernism are inspired by Gramsci's work on representation, ideology and civil society (Said, 1993; Murphy and Rojas de Ferro, 1995).

Gramsci's theory and concepts

Gramsci's thought is based on a seemingly eclectic set of sources (including, notably, the works of Benedetto Croce, LENIN, Niccolò Machiavelli, Georges Sorel and Giambattista Vico) and his critique of Second and Third International Marxism was at times severe. He

nevertheless remained a Marxist and the fundamental premises of his philosophy of praxis relate intimately to the themes KARL MARX raised in the *Theses on Feuerbach*.

Gramsci's basic conception of human nature can be understood with reference to the third of Marx's theses, which argues against the universalist conceptions of 'man-in-general' that are characteristic of liberal and conservative thought. Marx asserts that human nature is always forged within a specific material and social context: 'Men are products of specific material circumstances ... and changing circumstances change men.' But significantly for Gramsci's thought, Marx also argues against Feuerbach's materialism, because one should not forget that it is 'men that change circumstances': Humans are defined in, by and through their activity, and the social and material context changes as a cumulative result of activity (HISTORICAL MATERIALISM). Many Marxists would privilege the material moment, because they argue that the actions in which humans engage are defined by the social relations of production and attendant 'class positions'. Gramsci does not deny their importance, but he does put the subjective moment of action on a par with the material. This is because, drawing on Croce, he considers immanent creativity *as such* to have a distinct efficacy on will and action, in relation to material circumstance (Gramsci, 1971: 366–7). Society and humanity are generated through a complex interplay between material environment and ideas, where one depends for its very definition on the other. The result is a more contingent and open-ended conception of society and humanity than that found in orthodox Marxist theorization.

While not forgetting the importance of economics, Gramsci argued that ideological conceptions operated at such a fundamental level of subject formation, that it was impossible to conceive any concrete classes or other social groups outside them (Mouffe, 1979: 184, 186). This premise forms the basis of his key concept of hegemony, borrowed from Lenin but radically elaborated and reformulated. A hegemonic ideology of rulers was, for Gramsci,

necessary to ensure unity and cohesion between fractional groups of dominant classes (for example, between bankers, corporate shareholders and managers, and small-scale entrepreneurs). The instinctive economic-corporate conceptions they developed, each from their own experience, were too disparate to ensure automatically a common purpose. Hence a united bourgeoisie depended on a political and ideological osmosis, by which a certain world-view became so prevalent that it was taken as 'natural' and hence became hegemonic. According to Gramsci, hegemonic ideologies can and must also 'overflow' their class origin and play a key part in the forging of the 'common sense' of subordinate groups, thereby defining 'the general will' of society as a whole. To make hegemony compelling, however, certain economic concessions to subordinate strata may be required.

Hegemony expresses the strongest possible form of exercise of power, where the subordinate consent to their subordination. When such a stable order is achieved, there is a mutually reinforcing relationship between material, ideological and institutional realities – 'complex sets of structures and superstructures' – cementing the stable 'historic bloc' of an epoch. Developments of productive forces, a changing balance of power between classes or other social forces and/or a systemic questioning of established doctrine can, however, undermine such a historic bloc and generate its opposite. The opposite of a hegemonic historic bloc is an 'organic crisis'. In such a crisis, no group or conception is strong enough to assert itself and project a universally appealing order and general compromises between groups are not possible.

Organic crises are particularly prone to develop in certain eras and especially in peripheral societies. Material developments, class forces and doctrines cannot always congeal into a stable historic bloc, and this is especially so when dependency manifests itself as an 'external force' outside the control of domestic groups. In these situations it might nevertheless sometimes be possible for order to emerge. An individual agent may emerge in the

vacuum, seize state power and succeed in arbitrating or outmanoeuvring the contending groups. This type of rule is known as 'Caesarism'. In a historic bloc tending towards organic crisis, it might also be possible for ruling groups to pre-emptively reform a historic bloc and incorporate new and emerging strata of society ('passive revolution'). On the other hand, it might be possible for subordinate forces to build an alternative 'common sense' in the wake of mounting contradictions and forge a 'counter-hegemony'.

Gramsci's social theory can be understood as an approach to the analysis of power-politics and a guide to strategy. But Gramsci's putting of the 'subjective' on a par with 'objective' also has important philosophical implications for the conception of truth and freedom. These are tightly grounded in social relations in Marxist thought. In the *Theses on Feuerbach*, Marx argues that 'the point' of philosophy and social science should be to analyse the 'coincidence of changing circumstances and human activity' so as to reveal contradictions in existing orders in order to facilitate change – change that resolved contradictions and liberated those suffering under them. Such liberation would equal the realization of a more humanist and hence rational society. Gramsci did not question the *Theses* as such, but the manner in which they had been interpreted. For the Marxist orthodoxy of his time, the contradictions of capitalist society expressed essential relationships in the material base that were available as objective knowledge. These laws determined class struggle and would also reveal what exactly SOCIALISM would entail, as the forces of production (the material environment) developed and the workers' movement increasingly realized their historical mission of human emancipation. If class consciousness 'lagged', MARXISM–LENINISM argued that an intellectual vanguard could grasp these laws and should speed up the process. Gramsci was one of the first to critique such ECONOMISM for its defeatist isolationism and/or dogmatism. Crude economism has subsequently been discredited by Western Marxists, who generally acknowledge that the relationship between the

economic base, the consciousness of the oppressed, their aspirations, and the vision of a good and rational society is a great deal more complicated.

However, the Gramscian notion of hegemony complicates the interrelation of social relations, liberation and knowledge more consistently and radically than most other versions. As a result of the 'intermingling' of objectivity and subjectivity, it is not clear that it is possible to identify any essential subject to be liberated at all. How can one distinguish between liberatory aspirations or indeed even a 'fundamental class' from hegemonically constructed aspirations and identities? For Gramsci one cannot, in so far as knowledge is always intertwined with ideological expressions and hence is hegemonically constructed. This is indeed affirmed in his usage of Georges Sorel's concept of 'social myth', Vico's historicist conception of science (see HISTORICISM) and Machiavelli's insistence on grounding the scholarly treatise in political passion. But how, then, does Gramsci differentiate a 'myth' of liberation from one of oppression?

To Gramsci, one can differentiate 'myths' in terms of their relationship to freedom in so far as they are (or are not) grounded in and represent the intuitive aspirations of common people and subordinate groups. Here, Gramsci's theory comes close to that of György Lukács and the Frankfurt School. But while the latter might construe an overly stark distinction between emancipatory knowledge and power-determined ideology, Gramsci still has difficulties in asserting his socialist myth of liberation as the opposite of the Gentilian fascist popular myth. He resolves it with his inclusive concept of the 'integral state', by which he means that civil society and its groups *as a whole* are consensually represented in the state (indeed, become the state). Fascist populism, Gramsci argues, is exactly the opposite of this, since it is fundamentally based on essence and exclusion *a priori* determined by a dictatorship.

Gramsci's political science is based on using the difficulty of oppressive and exploitative orders to render compatible their ideological

common-sense claims of representing a general will, with the concrete experiences of the subordinated. Socialist political science should base its politics on this contradictory character of common sense and progressively construct a counter-hegemonic knowledge structure that aims at realizing the integral state. For Gramsci these contradictions are ultimately grounded in social relations of production and, in this sense, he remains firmly within the Marxist tradition: Capitalist orders are unable to achieve the promise of an integral state, since exploitation always implies that there is a discrepancy between everyday experience and hegemonic ideology.

The emphasis on subjectivity and cultural forms, and his rejection of economic reductionism, made Gramsci resurrect the Hegelian concept of civil society (market relations + associations and gatherings in the public sphere, not formally sanctioned by the state) that Marx had discarded. In the tenth *Thesis on Feuerbach*, Marx argues that the aim of historical materialism must be to transcend civil society – which he sees as a distinct feature of capitalism and bourgeois society – and assert ‘human society or socialized humanity’. However, Gramsci’s notion of the integral state implies that this socialization has to be understood as a transformation *within* civil society itself, since liberation can only be construed in terms of a rearticulation of already existing common sense. In particular, Gramsci seems to imply that civil society must be freed from its market-roots.

Civil society is not only a concept relevant to the ethics of liberation for Gramsci, but also for socialist strategy and his distinction between ‘war of movement’ and ‘war of position’. The terms refer to the different shape that revolutionary strategy must take in countries where the non-state public sphere is strong (that is, with a well-developed free press, a dense network of free associations and market relations, and so on) and where it is weak. When civil society is weak and ‘gelatinous’ (as in 1917 Tsarist Russia), it is possible for revolutionaries to capture power through a ‘war of movement’ when the old state collapses.

But when a society has a strong civil society ‘the earthworks and fortresses’ of civil societal institutions remain to defend the old hegemony, unless a ‘war of position’ has been successfully fought previously by counter-hegemonic forces redefining the terms of common sense. This insight was for Gramsci the key to understanding the failure of the socialist revolution after World War I. Despite the economic crisis and in some notable cases also the temporary collapse of state power, socialist revolutionaries did not succeed because they had not effectively forged counter-hegemony through a war of position. In particular, the reductionism of workers’ movements prevented them from forging consensual alliances with other subordinate social groups. As a result, in the case of Italy, the fascists could take advantage of the vacuum when the old Italian order collapsed.

Gramsci criticized economic reductionism. But this does not mean that he ignored the economy. On the contrary, he began to develop a method of understanding how production and exchange-technology interacted with cultural and political forms in the state and civil society to generate economic outcomes. He called this ‘qualitative economics’. He analysed how innovative (immanently creative) capitalists tried to mobilize and effect changes in cultural and political forms to overcome the inter-war crisis of industrial capitalism. In this context, he was the first to try to integrate the notions of TAYLORISM and Fordism into Marxist analysis.

See also:

agent–structure relations; class, definition of; critical realism; culture, economic role of; Marxism Leninism; neo-Gramscianism; philosophical realism; state theory

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J. MAGNUS RYNER

Great Depression

The Great Depression of the 1930s affected developing primary producers as well as major industrial nations; its severity prompted social and political changes in many of the worst-affected countries. It was in part a consequence of the so-called 'Great War' of 1914-18 and, in turn, contributed to the international political crises which prompted the outbreak of World War II in 1939. Much has been written on the causes of the Depression and its severity and longevity, but historians and economists still differ widely in their interpretations.

The 1920s were generally a period of economic prosperity but, even before the Wall Street Crash of October 1929, economic activity had begun to decline, particularly in Germany and the United States. Thereafter the volume of international investment dropped, industrial production fell and unemployment rose. At the same time, there were a series of bank failures, beginning in the United States and spreading to Europe after the collapse of Austria's largest bank, the Credit Anstalt in May 1931. In September 1931 the British government abandoned the gold standard in response to pressure on sterling. Meanwhile, measures taken by the Federal Reserve to halt the outflow of gold from the United States had an adverse effect on the already depressed American economy, as well as contributing to further banking failures. By 1933, American manufacturing output had

fallen to almost half its 1929 level and a quarter of the workforce was unemployed. As economic difficulties affected the major industrial powers, demand for products from the developing countries fell. There was a general retreat into economic nationalism and protectionism, exacerbated by the failure of the 1933 World Monetary and Economic Conference in London, attended by over sixty countries. Although the low point of depression was reached in 1932 and 1933, for many countries the path to recovery continued to be slow and was punctuated by downturns in 1937 and 1938.

The Depression had profound social and political, as well as economic, consequences. The initial reaction of many governments was deflation, accompanied by cuts in government spending and increased taxes. However, some countries engaged in more active economic management and public welfare programmes, often following changes of government. One notable example of this was the American New Deal. The massive unemployment experienced in the industrial nations stimulated increased spending on (and, in some cases, the introduction of) programmes of unemployment relief and public works.

The Great Depression has been much studied, at both the national and the international level. However, there is no clear consensus on either its causes or the explanation for its unusual severity and duration. It is not even universally agreed whether it originated in the United States or in Europe. Particularly during the 1940s and 1950s, it was suggested that the fortuitous coincidence in the downward turn of different business cycles accounted for the severity of the Depression. Keynesians, however, argue that the primary cause of the Depression was the drop in national income and in demand within the economy (see KEYNESIAN ECONOMICS). This was exacerbated by the Wall Street Crash and the banking failures; however, even before that, there had been a downturn in construction, the car industry and agriculture, reflecting the inability of demand to keep up with increased productivity. Monetarists, on the other hand, attribute the main responsibility for the De-

Great Leap Forward (GLF)

pression to the reduction of the American money supply in the period 1929–33; this, in turn, prompted a contraction in income, output and employment (see MONETARISM). MILTON FRIEDMAN and Anna Schwartz (1963) identify the Federal Reserve system in the United States as the main culprit. They argue that it failed to take appropriate action on discount rates and should have encouraged an expansionary policy.

One important criticism of the monetarist approach is that it focuses almost exclusively on events in the United States. Yet the dislocations in the world economy caused by World War I played their part: the war debts and reparations problem; the rapid transfer of economic power to the United States; the depressed state of the agricultural sector worldwide, and the inappropriate adherence by many governments to the gold standard (notably the United Kingdom, which returned to the pre-war parity with the dollar). CHARLES KINDLEBERGER (1973) emphasizes the breakdown of international economic cooperation and the decline in international investment, particularly long-term American investment. Although this affected Europe, and particularly Germany, it also had an impact on less developed countries. Kindleberger argues that the lack of a clear world economic leader – the United Kingdom was willing but unable to fulfil this role, the United States able but unwilling – was responsible for the length and severity of the Depression. This, however, presupposes that a hegemonic power would have been prepared to carry the costs of leadership.

Each nation experienced the Depression differently. In some, such as the United Kingdom, it was virtually over by 1934, when the British economy returned to its (rather poor) 1929 economic levels. Among the industrial nations, the United States and Germany were the worst affected. They adopted some similar policies, notably public works and increased government management of the economy. However in Germany, unlike the United States, the Nazi Party relied on rigid control and the direction of labour to bring about the restoration of full employment. The American econ-

omy only returned to prosperity with the outbreak of war in Europe. The experiences of the Great Depression helped pave the way for the adoption of Keynesian policies after World War II.

See also:

hegemonic stability; hegemonic stability theory; long cycles; National Industrial Recovery Act; Smoot-Hawley Tariff

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FIONA VENN

Great Leap Forward (GLF)

The Great Leap Forward (GLF) refers to the policy of social and economic engineering launched by the Chinese Communist Party (CCP) in 1958. Primarily associated with Mao Tse Tung, the GLF had two main aims. First, to overcome production bottlenecks which had resulted from the first, Soviet-inspired, Five

Year Plan (1953-7). Second, to undermine the power of an emerging bureaucratic and technocratic elite. The prime feature was the reliance on the 'revolutionary enthusiasm' of the masses. This was to be tapped through the mass-mobilization of the population, either directed towards public works programmes or through the creation of agricultural communes. In addition to investment in the modern sector of the economy, the CCP encouraged local industrial production (in particular small-scale steel production). Western academic accounts of the GLF are overwhelmingly negative. There were some increases in production and some large-scale building projects were completed. However, dislocations in the agricultural sector, brought about by the switch to the commune system and the diversion of agricultural workers to industrial projects, had a disastrous impact on food production. At least 20 million people died of starvation between 1958 and 1961. The GLF policies were a factor in the Sino-Soviet split and led to a schism in the leadership of the CCP which paved the way for the Cultural Revolution.

See also:

communism; Maoism; planned economies

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STEPHEN HOBDEN

green movement

In the 1970s, the green movement was originally a loose network of people of several constituencies: peace activists, feminists, social justice activists, radical ecologists, decentralists and participatory democrats. The basic political principle of these people was opposition to hierarchy, patriarchy and authoritarianism.

Hence, green policy can only be made by local grassroots organization.

Despite this belief of early activists, in the 1980s in some countries Green Parties were founded. More and more local networks had grown into regional and national organizations. In 1998, for the first time in history, a Green Party member became part of ruling government: since September of that year, the German Minister for Foreign Affairs has been a Green. At present, there are even international Green organizations. Two of the most popular are the INTERNATIONAL NON-GOVERNMENT ORGANIZATION (INGO) Greenpeace and the World Wide Fund for Nature (WWF). Their political power has grown rapidly, as the case of the Brent Spar oil platform in the North Sea showed.

Members of the green movement have expanded their goals from preventing pollution and promoting equal rights for women, to encouraging the development of appropriate science and technology and improving social welfare. Everywhere that Green organizations have been established, this expansion has led to structural conflicts between 'radical' Greens, on the one hand, and 'realists', on the other. In most cases, the 'realist' majority have triumphed.

But the core values of the green movement remain the same: humankind is uniquely responsible for the care of the planet – it is responsible for controlled economic growth, for a careful use of finite resources. In their opinion, the world must be held in trust by the present generation for all future generations; only sustainable economic and social development avoids doing irreversible damage to the environment.

JUERGEN M. SCHECHLER

green revolution

The term 'green revolution' refers to the increase of agricultural output in developing countries in the 1960s that led to dramatically increased yields. New varieties of wheat and

rice, helped by heavy use of fertilizers, pesticides and vast amounts of irrigation, led to the short-term doubling and even trebling of agricultural yields in the Middle East, Far East, North Africa and Latin America. The US agronomist Norman Borlaug received the Nobel Peace Prize in 1970 for developing these high-yield crop varieties.

Despite its obvious successes, the green revolution was criticized as early as the 1970s for its ecological and socioeconomic consequences. Although heralded by many as the end of famines, it became clear that these extraordinarily high yields could only be obtained under optimal conditions, which included the maintenance of high levels of irrigation and the use of intensive farming methods in the form of heavy fertilization, monocultures and high pesticide use. These intensive farming methods led to eutrophication of freshwater resources and health hazards for local inhabitants. In addition, many rural areas in developing countries simply did not have the energy resources necessary to power the machinery necessary for these intensive farming methods: the green revolution favoured large landholders with access to machinery. In consequence, small landowners were unable to compete with their larger counterparts and often gave up their farms, leading to changed agricultural management patterns. Social structures and the social composition of the countryside changed and the creation of a landless rural class ensued.

In the 1980s, the soil capacity of the fields of the green revolution was exhausted and soil fertility declined dramatically as even higher doses of fertilizers and irrigation were needed. The green revolution had thus not achieved its aim of providing food for the world's poor: the poor in developing countries were now unable to rely on local produce for survival because much of it was too environmentally degraded for consumption, and because they could not afford it.

GABRIELA KÜTTING

Gresham's Law

Simply stated, Gresham's Law is 'bad money drives out good'. For example, if two gold coins of equal face value but each with a different pureness of gold are simultaneously circulated, the coin with a higher intrinsic value will be hoarded. There are historical exceptions to Sir Thomas Gresham's sixteenth-century observation. Nevertheless, this 'law' remains a popular precept taught in most basic economics courses.

JONATHAN R. STRAND

grey imports

The practice of selling similar goods at different prices in different national or regional markets makes it possible that such goods can be re-exported from countries in which they are relatively cheap to those in which they are more highly priced, and in which they can be resold below prevailing official prices but still at a profit to the local importers. Improvements in international communications have encouraged the growth of such 'grey imports', despite a number of attempts by the manufacturers of the affected goods to secure legal restrictions on the process, whether by national authorities or through such regional agencies as the EUROPEAN COMMUNITY (EC).

See also:

re-exports

R.J. BARRY JONES

gross domestic product (GDP)

Gross domestic product (GDP) is a measure of the economy's total output. It measures the output produced by factors of production located domestically regardless of who owns them. It can be measured by two different methods. First, it can be calculated on the

expenditure side of the circular flow of income by determining the value of total production. Second, it can be calculated on the income side of the circular flow of income by determining the value of the incomes generated by productive activities.

On the expenditure side, GDP is calculated by adding up the total expenditures on final output, which is the sum of private consumption, private investment, government expenditure (on consumption and investment) and net exports. Private consumption is all private household expenditure on goods and services. Private investment includes all expenditure by private firms on the production of goods not for present consumption. A distinction should be made between gross and net investment. Gross investment is the total amount added to the capital stock and inventories and comprises two components: first, net investment (which increases the stock of capital) and, second, depreciation or capital consumption allowance (which is replacement investment that keeps the existing stock intact by replacing worn-out capital). GDP includes gross investment. Government expenditure includes both consumption and investment. Government consumption only includes purchases of goods and services, not transfer payments. The latter are expenditures not made in return for currently produced goods and services. In so far as they are spent by others (for example, by beneficiaries of social security payments), they are included in private consumption. Net exports are equal to total exports minus total imports. Therefore, net exports may be negative.

On the income side of the circular flow of income, GDP is calculated by adding up all factor incomes (wages, rent, interest and profits) and non-factor payments. Wages are all payments for the services of labour and include taxes withheld, pension-fund contributions and so on. Rent is payment for the services of all factors that are rented including land, buildings and so on. Homeowners are considered to rent their homes from themselves and rent thus includes not only real payments, but also imputed rent for owner-occupied

housing. Interest includes the interest earned on financial capital such as bonds, bank deposits and so on. Profits made by businesses may be paid out as dividends to a firm's owners (for example, shareholders) or retained for use by the firm. GDP includes both distributed and retained profits. Non-factor payments include depreciation and indirect business taxes (on the production and sale of goods and services) net of government subsidies on goods and services. GDP thus includes the balance of indirect taxes and subsidies.

In summary, GDP can be calculated from both sides of the circular flow of income: the expenditure side and the income side. Calculated from the expenditure side it is the sum of private consumption, private investment, government expenditure and net exports. Calculated from the income side, it is the sum of the factor incomes generated in the production process plus depreciation plus indirect taxes net of subsidies.

M. PETER VAN DER HOEK

gross national product (GNP)

Gross national product (GNP) is a measure of the economy's total income. It measures the income received by domestically owned factors of production regardless of where they are located. For example, inhabitants of the euro zone may hold US Treasury bonds or own shares in American companies. Thus, they will receive interest or dividend payments from the United States. These payments are not included in the euro zone's GDP, but in the GDP of the United States because they reflect income produced in the United States. These payments accrue to euro zone residents. Therefore, they are included in the euro zone's GNP, not in the GNP of the United States. At the same time US residents might own shares in the euro zone companies. The dividends they receive are included in the euro zone's GDP because they reflect income produced in the euro zone. However, these dividends are not included in the euro zone's GDP. Since they accrue to US

residents, they are included in the GNP of the United States.

Which measure is to be preferred, GNP or GDP, depends on the purpose. GDP measures domestic economic activity, whereas GNP measures income received by domestic residents. The relative sizes of GNP and GDP depend on the balance between factor payments from and to foreign countries. This may change over time. The United States, for example, was a net creditor country until the mid-1980s. As a result, factor payments going to US residents but generated outside the United States exceeded factor payments generated in the United States but accruing to non-US residents. After the mid-1980s, however, the situation reversed and the United States became a net debtor country. As a result, the balance of factor payments from and to foreign countries became negative and GNP lagged behind GDP in the United States. For some countries there is a substantial difference between GNP and GDP, but in most economies these measures do not differ very much. Factor payments accruing to foreigners or earned abroad may be small relative to GDP, or both payment flows may roughly balance.

GNP is a far from perfect measure of economic activity. A variety of economic activities are excluded from measured GNP, including services of homemakers, do-it-yourself activities, unreported (often illegal) activities and the value of leisure. Thus, GNP underestimates total output. On the other hand, it overstates total output because it includes nuisances such as environmental damage, congestion, noise and so on. The value of nuisance goods that are created in the production process should be deducted, whereas the value of non-market and unreported output should be added, if economic WELFARE is to be measured more accurately. The result could be called Net Economic Welfare (NEW). Even such a measure, however, would not be perfect. Non-market output and most nuisance goods can only be determined arbitrarily. For example, is the value of the services of all homemakers the same or are there differences? GNP is thus a fairly crude

measure of the *level* of economic well-being and of the overall flow of goods and services available to satisfy people's wants. Changes in GNP, however, are likely to be reasonably good measures of *changes* in economic welfare.

M. PETER VAN DER HOEK

Grotius, Hugo (1583–1645)

Hugo Grotius was born in Delft in the United Provinces of the Netherlands, but died in exile. Until 1619, he was one of the rising stars of Dutch politics. In 1607, he was Advocate-Fiscal of the Province of Holland, the most important of the seven provinces, and between 1613 and 1618 he served as the city of Rotterdam's pensionary, or mayor. This appointment effectively made Grotius one of the most powerful men in the Province of Holland. As a supporter of Johan van Oldenbarnevelt, the leader of the Province of Holland and an opponent of the centralist and religiously more strict party of the Stadthouder of the United Provinces, Prince Mauritz, Grotius fell from political favour after the coup that toppled Oldenbarnevelt. Sentenced to life imprisonment in 1619, Grotius escaped to Paris, where he became a pensioner of Louis XIII, and acted as Swedish ambassador to France. It was during his exile in Paris that he published his best-known work, *De Jure Belli ac Pacis* (1625 [1625]). Despite being highly regarded during his lifetime, he was not invited to assist in the negotiations that led to the Treaties of Westphalia.

Although commonly regarded as the father of international law, Grotius' own intentions were much more modest. His early works, written during his political career, gave intellectual support to the policies of Oldenbarnevelt's faction. *Mare Liberum* (1625 [1608]), advocating the freedom of the seas, was a direct attack on Spanish commercial monopolies and English claims to exclusive fishing rights in the North Sea. Grotius' theological writings advocated a doctrinal tolerance in line with Oldenbarnevelt's policy of closer relations with Catholic France and Anglican England,

as well as reconciliation with Catholic Spain. After his exile, Grotius' writings reflected the disgust that many European intellectuals felt for the almost constant and brutal warfare of the early seventeenth century. Yet this disgust was not with war itself, but rather with the way that war was being used. Instead of attempting a radical reform of state practice, Grotius' intent was to find a moral basis for the current political system, and thus to soften and lessen some of the excesses of that system through the discovery of generalized rules based on natural law.

The basis of Grotius' thought is a belief in a natural law upon which human laws can be based and by which human action can be judged. This natural law is timeless and cannot even be changed by God. Since, for Grotius, law exists in a state prior to society (a claim refuted by earlier humanists like Justus Lipsius and Michel de Montaigne), it followed that law does not require government in order to exist. All human action was, therefore, subject to law. Taking this position, Grotius did not need to prove that there was a society of states in order to claim that states were subject to law. Again, this provided a sharp distinction with the sixteenth-century humanists, who regarded law as a product of the necessity of social relations. Despite this, however, Grotius did argue that states formed a rudimentary society of states that was analogous to a society of individuals, and that this society had its own set of laws derived from natural law. In the absence of more sophisticated legal procedures, however, states used war to settle the disputes that occurred within the society of states. In order for the use of war to be in harmony with natural law, it was necessary for war to have a just cause (*jus ad bello*). At the same time, whether the war was just or unjust, natural law made it an imperative that the war be fought justly (*jus in bello*). Grotius' position on the utility of war led IMMANUEL KANT, who believed that reason condemned war as a means of settling disputes, to denounce Grotius as one of the 'sorry comforters' who justify the use of war.

While most of Grotius' contribution to the laws of war occurred after his exile, his work on the freedom of the seas (written during his political career in Holland) reflected the political platform of the Dutch government at the time. *Mare Liberum*, which made the case against the idea that seas could be owned by states, was published during negotiations with the Spanish (in which the Dutch right to trade in the East Indies was being questioned) and soon after England had claimed jurisdiction over the North Sea. *Mare Liberum* gave intellectual weight to the position of the Dutch East India company and Dutch fishing interests. Grotius' argument for the freedom of the seas rested on two propositions. The first argued that the right to travel in order to trade was part of natural law. He deduced this from the distribution of resources and trades over the surface of the world, which made trade necessary to sustain life. Since God had been responsible for this distribution, it stood to reason that God had intended commerce. It was therefore only just that all nations should be allowed to travel freely on the sea. The second proposition argued that the nature of the sea (constantly in motion, like the air, and covering most of the globe) made it impossible to extend ownership over it in the same manner that ownership was extended over land. As a result, the sea was a common resource like the air. Although superseded by developments in the Law of the Sea over the last three centuries, Grotius' defence of the freedom of the seas is still regarded as seminal.

Grotius' popularity with later generations, and his position as the father of international law, owes as much to the timeliness of his writings as it does to the nature of his ideas. The intellectual mood of the second quarter of the seventeenth century was turning against the sceptical humanism that had dominated the sixteenth century. Sixteenth-century advocates of *raison d'état* (such as Giovanni Botero and Lipsius) had called into question all laws and moral imperatives in politics except those based on self-preservation. In response to growing political disorder, however, European thinkers after 1620 sought justification for

Group of 3 (G-3)

political order and stability. Natural law became a popular intellectual means to justify the very laws of conduct that had been questioned a century before. In this sense Grotius, like his contemporary THOMAS HOBBS, used the concept of natural law as a means to justify the state order. Yet, like Hobbes, his philosophy had an unintended radical side to it that competed with its conservative pretensions. By using natural law to defend the conservative order, Grotius also put legal limits on the use of power by conservative elites. The embryonic notion of the common heritage of humankind contained in his *Mare Liberum*, for example, challenged the notion of state primacy that developed from the Treaties of Westphalia.

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LUCIAN M. ASHWORTH

Group of 3 (G-3)

The Group of 3 (G-3) is a shorthand term for the triumvirate comprising the EUROPEAN COMMUNITY (EC), Japan and the United States that effectively dominates the world economy.

R.J. BARRY JONES

Group of 3 (G-3), Latin American

The Group of 3 (G-3) is a reciprocal tariff elimination agreement implemented by Colombia, Mexico and Venezuela in January 1995. Its principal goal is to achieve duty-free trade by 2005. The G-3 is the first trading bloc in the hemisphere to tackle the challenging issues of intellectual property rights and trade-related investment measures.

WILLIAM P. AVERY

Group of 5 (G-5)

In 1973, the US Secretary of the Treasury invited the finance ministers of France, Germany and the United Kingdom to an informal discussion. They discussed the international monetary situation and agreed to pursue further discussions and invite the Japanese to participate as well. The press dubbed the finance ministers' get-togethers as Group of 5 or G-5 meetings.

M. PETER VAN DER HOEK

Group of 7 Finance Ministers (G7FM)

The G7 finance ministers' (G7FM) meetings have become the key forum for international economic policy coordination and for responding to international financial crises. The finance ministers and central bank governors of the G7 countries (now joined by the head of the European Central Bank and a representative of the EU) usually meet three times per year, while their deputies meet approximately every six weeks. Before 1987, the meetings usually involved only the GROUP OF 5 (G-5) countries (France, Germany, Japan, the United Kingdom and the United States). The 1986 Tokyo Summit formalized the process and

expanded it to include Italy and Canada. The G7FM engages in informal multilateral surveillance of national policies, sharing information and opinions about their own and each others' fiscal and monetary policies, the hope being that this will encourage each government to adopt policies conducive to international macro-economic stability. The G7FM also monitor and discuss exchange rate movements and other developments in the international financial system.

In the 1990s, the focus of economic policy coordination shifted even more toward the G7FM and away from the G-7 (now G-8) summit meetings. This shift was driven both by the increasing prominence of political issues at summit meetings after the COLD WAR and by the determination of finance ministers and (especially) central bank governors to retain control over economic policy coordination at the expense of heads of government, who were felt to be too responsive to domestic political pressures for expansionary policies. The G7FM rarely reach explicit agreements and, as an institution, have no direct powers over national governments or international organizations. However, the G7FM play a key role in developing a consensus among major powers on key international economic issues, and their discourse has a major influence on how national governments and international organizations such as the INTERNATIONAL MONETARY FUND (IMF) respond to economic problems.

In the mid-1980s the G-5 and G7FM did reach a number of international agreements that helped reduce international imbalances (including the PLAZA and LOUVRE ACCORDS) and, late in the 1980s, the process encouraged all G-7 governments to tighten monetary policies in the face of modest inflationary pressures, thus helping to trigger the recession of the early 1990s. In the 1990s, the G7FM generally eschewed explicit agreements on mutual policy adjustments, instead encouraging all states to reduce fiscal deficits and use monetary policy to fight inflation, while tackling problems such as high unemployment and slow growth through micro-economic struc-

tural reforms to increase labour market flexibility and the role of market forces in general. Partial exceptions were occasional efforts by the United States to promote growth through fiscal and monetary expansion in Japan and the European Union, though the latter were vociferously resisted by German officials. There has also been a marked reluctance to intervene in a coordinated fashion to stabilize exchange rates since the 1990s, due to an exaggerated perception of government powerlessness in the face of open international financial markets. Instead, the G7FM have occasionally endeavoured (with mixed success) to persuade foreign exchange traders to move exchange rates in desired directions. The G7FM have also played the leading role in overseeing the management of international financial crises and in formulating proposals for reforms of the international financial system (for example, the G7FM's initiatives approved at the 1995 Halifax G-7 Summit). Their orientation in this area has been to preserve and enhance openness in international financial markets, to encourage transparency in government policies and to force emerging market economies to continue the process of liberalization while strengthening national financial regulation in cooperation with Western-based international financial institutions and regulators (for example, the IMF and the BASLE COMMITTEE ON BANK SUPERVISION).

Analysts disagree about the impact of the G7FM. Some see it as the key institution at the apex of global economic governance, whose main objective is to promote open international capital markets, while others see its difficulty in reaching explicit agreements on policy adjustments and exchange rates as evidence of its modest relevance.

See also:

Group of 7 (G-7), policy coordination in the

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Group of 7 (G-7)/Group of 8 (G-8) Economic Summit

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MICHAEL C. WEBB

Group of 7 (G-7)/Group of 8 (G-8) Economic Summit

The heads of state and government of France, Germany, Italy, Japan, the United Kingdom and the United States have been meeting annually since 1975. They have been joined by the Prime Minister of Canada since 1976, hence they are known as the Group of 7 (G-7), although they have been joined by the President of the European Commission since 1977. (The European Union is also represented by its president; in years when the presidency is not held by a G-7 country, the President of the European Council attends to represent the EU in its own right.)

The summit has no institutional status or direct links with any international organization. The output of the meetings is usually one or more documents recording discussions among leaders or their agreements on action they will take individually or collectively in other places. Summits are prepared by personal representatives of the leaders, known as 'sherpas', who meet three to five times a year both alone and accompanied by a senior official from the foreign and the finance ministries, known as 'sous-sherpas'. Foreign and finance ministers joined leaders at the summit until 1998, when they met together a few days ahead. Foreign ministers have had separate meetings since 1984, and *ad hoc* meetings of ministers or lesser officials are also held from time to time to report to leaders on specific issues, such as money laundering or the global information society. G-7 trade ministers have been meeting separately as the Quad since 1981 (see QUADRILATERAL GROUP OF TRADE MINISTERS). The

GROUP OF 7 FINANCE MINISTERS (G7FM) was created as a separate group in 1986 to manage more active economic policy cooperation. They now meet several times a year with Central Bank Governors and the INTERNATIONAL MONETARY FUND (IMF) Managing Director often joins the meetings.

With the end of the COLD WAR in the 1990s, the President of the Russian Federation gradually became involved, first through invitations to dinner with the G-7 leaders and later through engagement in the preparatory process. Since 1997, the summit has been referred to as the G-8, when almost-full membership and the promise of integration into the international political system helped reconcile Russia to NORTH ATLANTIC TREATY ORGANIZATION (NATO) enlargement. The G-7 still meet on some economic issues, however, and Russia does not participate either in the Quad or in the G7FM.

The core summit agenda includes macro-economic issues in both their domestic (for example, employment) and international dimensions, international trade and relations with developing countries. Political and security issues, from arms control to terrorism, have frequently been on the agenda, justifying Russian participation. Transnational issues such as the environment, crime and drugs increasingly interest leaders, as do domestic issues where they benefit from sharing experience with each other. In 1998, leaders discussed:

achieving sustainable economic growth and development throughout the world in a way which, while safeguarding the environment and promoting good governance, will enable developing countries to grow faster and reduce poverty, restore growth to emerging Asian economies, and sustain the liberalisation of trade in goods and services and of investment in a stable international economy; building lasting growth in our own economies in which all can participate, creating jobs and combating social exclusion; and tackling drugs and transnational crime which threaten to sap this growth,

undermine the rule of law and damage the lives of individuals in all countries of the world.

(University of Toronto G-7
Information Centre, 1998)

The creation and *de facto* institutionalization of the summits do not signal the demise of traditional diplomacy as much as the perception by leaders of a new sort of problem. The apparent inability of the United States to manage the international economic system on its own after 1971, and a growing realization that the process of INTEGRATION intentionally fostered by the BRETTON WOODS SYSTEM was associated with a great deal of less welcome INTERDEPENDENCE, changed the meaning of 'foreign' policy. The summit fills the gap between international economic activity and domestic political authority. Leaders must address the spill-overs from one policy domain, or ISSUE AREA, to another because only they have responsibility for all aspects of government.

The group was defined functionally. The structure of power varies from issue area to issue area but, on international economic matters, the G-7 collectively are preponderant both materially and politically. Measures of international transaction flows are more useful than a GNP league table of the 'largest' economies. On such measures, the four smaller members of the original G-7 are vital to at least one of the others. The smallest, Canada, is the world's fourth largest trader after the United States, the EU and Japan, and it is one of the world's largest homes and hosts for foreign investment. The G-7 are the countries who benefit from systemic stability and who have a major responsibility for bringing it about. Neither populations nor currencies are 'represented' in the summit, which is why European participation will be unaffected by the creation of the euro and why China will not be a member any time soon. This apparent failing might matter if the summit took decisions binding on anybody other than its members, but it does not. It helps its members play a

collective leadership role in global governance (see GOVERNANCE, GLOBAL), but the summit is not itself an institution of governance. The G-8 cannot run the world economy, but they can coordinate their own policy, which is no small contribution.

The most important issue area for the G-7 is money. The first summit at Rambouillet in 1975 facilitated revision of the IMF Articles of Agreement, but the creation of the summit itself was a *de facto* modification of the Bretton Woods system, as were the (unsuccessful) coordination experiments tried by the G-7 at Bonn in 1978 and by their finance ministers with the PLAZA ACCORD in 1985 and the LOUVRE ACCORD in 1987. Twenty years later, leaders were again preoccupied with reform of the institutional architecture. Proposals endorsed at Halifax in 1995 and again at Lyons the next year led to strengthening of the financial system. The summit also ensured a coordinated response to the Asian financial crisis of the late 1990s. In the issue area of trade, summit action was important in 1978 for ending the TOKYO ROUND; in 1985 and 1986 for launching the URUGUAY ROUND; in 1988 for making progress on agriculture, and in 1993 for bringing the Uruguay Round to an end. The engagement of leaders was needed to resolve disagreements among the G-7 themselves, after preparation by their trade ministers in the Quad (see QUADRILATERAL GROUP OF TRADE MINISTERS), which removed impediments to wider progress because of their collective weight in world trade. G-7 action has been influential in a great many other domains, such as strengthening the INTERNATIONAL ATOMIC ENERGY AGENCY (IAEA) after Chernobyl, though its attempts to avert conflict among its members are not always successful (for example, at the 1997 Climate Change Conference at Kyoto).

Countries excluded from the summit frequently try to influence its deliberations, but most such demands are deflected or accommodated on an *ad hoc* basis. As a result of the demand of members of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) for closer consultation, however, the

Group of 7 (G-7), policy coordination in the

annual Ministerial Council of the OECD is held a few weeks before the summit, often with a similar core agenda. Maintaining the link is important: the summit cannot replicate the analytic work of the OECD, while discussion among leaders often gives more impetus to OECD ideas. For a similar reason, the heads of the IMF, the WORLD BANK and the WORLD TRADE ORGANIZATION (WTO), and occasionally the Secretary-General of the United Nations (UN), meet with G-8 Foreign and Finance Ministers.

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ROBERT WOLFE

Group of 7 (G-7), policy coordination in the

Policy coordination in the Group of 7 (G-7) refers to the potential or actual mutual adjustment of monetary, fiscal and exchange rate policies of the leading industrialized countries to stabilize the global economy (see FISCAL POLICY; MONETARY POLICIES), one of the core areas of work of the G-7. Growing international INTEGRATION of national economies in the post-World War II era meant that independently chosen monetary and fiscal policies were having greater effects on foreign countries and on international stability through the mechanisms of trade imbalances and, especially, transnational flows of capital. Rising capital mobility and currency speculation in the 1960s led to the collapse of fixed exchange rates, the central coordinating me-

chanism of the BRETTON WOODS SYSTEM, in 1971–3. Proponents had predicted that flexible exchange rates would enable governments to pursue domestically oriented monetary and fiscal policies free from international constraints, but speculative capital flows proved instead to be extremely destabilizing. Small changes in interest rates or in investors' perceptions of the future course of monetary and fiscal policies could generate massive capital movements, threatening expansionary governments with CAPITAL FLIGHT and CURRENCY DEPRECIATION (for example, France in the early 1980s or the United States in 1986–8), while anti-inflationary monetary policies could generate capital inflows and excessive currency appreciation (for example, the United States in the early 1980s, Germany in the early 1990s). The growth of international capital markets had undermined national economic regulation and management, and created a need for coordinated regulation or what some called an 'internationalization of authority' over market forces that were increasingly transnational. Interest in policy coordination also rose out of the challenges posed by the oil crisis of 1973–4 and the perception of a need for collective economic management in an era of diminished US power and leadership.

The contemporary process of G-7 policy coordination occurs primarily through meetings of finance ministers and central bank governors (and their deputies) from the G-7 countries, meetings which occur several times each year and which have occasionally served as a forum for multilateral surveillance of national policies. This process evolved out of information meetings of the GROUP OF 5 (G-5) finance ministers in the early 1970s and has occasionally been linked to the G-7 summit meetings of heads of governments, though the latter have been less relevant to the process of policy coordination since the mid-1980s as the public relations and political elements of the summits have become more prominent (symbolized by the increasing participation of Russia in summits after the mid-1990s). Policy coordination in the G-7 is clearly dominated by Germany, Japan and the United States, with

the key discussions often being conducted on a bilateral basis between the United States and either Japan or Germany.

The record of policy coordination in the G-7 has been mixed. Exchanges of information and opinion at G-7 meetings may enable national policies to be made on the basis of better information about international conditions, but efforts to negotiate mutual policy adjustments have rarely had a substantial impact. Some political leaders and observers have called for policy coordination to support and stabilize world economic growth – an international form of Keynesian demand management (see KEYNESIAN ECONOMICS). Coordinated reflation (including relaxed monetary policies and larger debt-financed government spending) could overcome the deflationary bias alleged to exist when policies are not coordinated (in the absence of coordination, governments may be forced to avoid stimulative policies even when required by the fear of capital flight and currency depreciation). G-7 policy coordination did lean in this direction on two occasions, both times largely in response to US pressure – the 1978 Bonn Summit, which agreed on the locomotive strategy of coordinated stimulus in Germany, Japan and the United States to accelerate growth, and the 1987 LOUVRE ACCORD and associated understanding. On the latter occasion, stimulative measures introduced by Japan and Germany did help shrink the US trade deficit and support the dollar, but were also blamed (as was the Bonn Summit agreement) for fuelling inflation. Others have seen the process of policy coordination as another mechanism for enforcing orthodoxy in macro-economic policies (as in other types of policy), as part of a transnational process of social-consensus development among ruling groups. G-7 efforts have often leaned in this direction. Consultations in the G-7 since the late 1980s strengthened the mutual determination of central banks to resist inflation by monetary means and to assert the growing independence of central banks from national political authorities – central bankers also meet on their own in the BANK FOR INTERNATIONAL SETTLEMENTS (BIS). G-7 meetings in the

1980s and 1990s frequently criticized members' high budget deficits, though the persistence of large deficits in most G-7 countries until the late 1990s testifies to the limited impact of policy coordination in this area.

The weakness of coordination of monetary and fiscal policies has contributed to continued volatility and misalignment of exchange rates, and policy coordination in the G-7 has often focused primarily on exchange rates. There have been numerous proposals for coordinated intervention in foreign exchange markets to stabilize G-7 currencies (particularly the dollar–yen and dollar–mark exchange rates) within target ranges, and such a scheme was introduced (with secret ranges) with the 1987 Louvre Accord. However, the agreed ranges were soon breached. More often, the G-7 has coordinated intervention on an *ad hoc* basis when governments agree that markets have overshot appropriate rates. Coordinated intervention can have a substantial impact (see PLAZA ACCORD), though many in the G-7 have become sceptical because foreign exchange markets are now so large relative to central banks' foreign exchange reserves. But the ability of the G-7 to achieve its exchange rate objectives is more importantly constrained by its inability to coordinate the monetary and fiscal policies that drive much currency speculation.

Overall, policy coordination in the G-7 has had a modest impact. These governments have been able to coordinate policies under crisis conditions, when a failure to adjust policies would lead to extreme currency misalignment or to trade imbalances so large that they threaten to generate protectionism (as in the period after 1985, when policy coordination helped to reduce the US trade deficit – particularly with Japan – and defuse protectionist pressures in Congress). But the G-7 has been unable to develop ongoing mechanisms to adjust policies to maintain international economic stability and prevent crises from emerging, or to manage volatile foreign exchange markets (for example, the G-7 has rejected the idea of a tax on foreign exchange transactions to deter speculation). The obstacles to more substantial policy coordination are numerous. Monetary and (especially) fiscal policy-making

Group of 10 (G-10)

is oriented primarily to domestic problems and consequences in the largest G-7 countries, and G-7 meetings are only a minor adjunct to this process. Coordination of fiscal policy also is difficult because persistent fiscal deficits and the political difficulty of raising taxes or cutting spending has immobilized fiscal policy in many countries. Fiscal paralysis has also undermined G-7 governments' trust in each other, with the German, Japanese and US governments all believing that their foreign counterparts have failed to fulfil their fiscal policy commitments. Ideological disagreements among governments about the appropriateness of various policies pose another obstacle to coordination, though these differences have probably narrowed in recent years. A consensus, partly fostered by the G-7 process itself, has emerged in favour of orthodox, supply-side-oriented macro-economic policies. This consensus orients monetary policy primarily towards preventing inflation, favours central bank independence from political authorities who might press for more stimulative policies and frowns on explicit manipulation of fiscal policy to manage demand in a counter-cyclical fashion.

Finally, G-7 policy coordination is becoming less salient as European members of the G-7 increasingly discuss and coordinate these types of policy in the EUROPEAN UNION (EU).

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MICHAEL C. WEBB

Group of 10 (G-10)

The Group of 10 comprises the major industrial countries: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States. They are the most important member countries of the INTERNATIONAL MONETARY FUND (IMF) in terms of the volume of their international payments and their voting power within the IMF.

M. PETER VAN DER HOEK

GROUP OF 22 (G-22) see new international financial architecture

Group of 77 (G-77)

The Group of 77 (G-77) was established on 15 June 1964 during the first UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) in Geneva when seventy-seven developing countries signed the Joint Declaration of the Seventy-Seven Countries. The group retained its name despite its membership rising to 133 countries. The first ministerial meeting

of G-77 took place in Algiers in 1967 when the Charter of Algiers was adopted and the gradual development of a permanent institutional structure of the G-77 was initiated.

The G-77 was the largest coalition of developing countries and aimed to articulate and promote common economic interests and enhance joint action concerning all major economic issues dealt with in the United Nations system. Meetings took place before important sessions of the General Assembly in order to arrive at a common position on specific issues.

The G-77 frequently criticized what they called the neo-colonial policies of the FIRST WORLD and emphasized the need for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) (see also NEO-COLONIALISM). The NIEO, which was adopted by the UN General Assembly in 1974, politically acted through the G-77. It was supposed to be a platform for developing countries in their demand for a trade balance between North and SOUTH, but finally failed because of lack of common ground between its supporters. The importance of the G-77 has been further diminished by a trend towards bilateral and regional negotiations.

MEHDI PARVIZI AMINEH

growth poles

The term 'growth poles' originates with François Perroux's seminal work, 'Note sur la notion de "pôle de croissance"' (1955). Perroux refuted the standard state-equilibrium explanation of how economies grow. Such a representation, according to Perroux, discounted the facts that (1) industries appear and disappear; (2) there are variable production flows within diverse industries measured over time; (3) the growth of an industry, industries or a group of industries may diffuse from a central point over time, and (4) the products or structure of an industry may be transformed with the passing of time.

Perroux suggested that growth does not appear everywhere at the same time: it becomes

manifest at points or poles of growth of variable intensity, spreading through different channels with variable terminal effects on the whole economy. Specifically, Perroux defined the growth pole as 'a set that has the capacity to induce the growth of another set' (1955: 309). The effects implicit in this approach are (1) the pole is a concentration of productive elements; (2) growth is propagated from a focal point – in other words there is a diffusion of growth and spill-over effects from the pole into the surrounding hinterland; (3) as the large firms act as magnets, they demand investment to fulfil their role and to ensure regional growth, and (4) in a developing region or country, (the appropriate) multinational enterprise can act as an indigenous company with the same advantageous effects.

Contrary to what is usual in pure economic theory, the theory of DEVELOPMENT poles, particularly as conceived by Perroux, is derived inductively from observations of the actual process of economic development. Based on his field experience and observations, Perroux was led to consider development as essentially polarized in the sense that forces inherent in the development process worked towards the clustering of economic activities and growth, and towards an imbalance between industries and geographical areas. His theory is essentially a theory of development, that is, a theory which purports to explain the entire process of STRUCTURAL CHANGE in the economic as well as in the social and even institutional systems, as opposed to a theory of economic growth which concentrates on the conditions for expansion of aggregate production and total income.

Perroux's approach makes an important distinction between the terms 'growth pole' and 'growth centre'. This distinction relates to differences between geographic space and economic space. Perroux originally discussed the concentration of growth poles in abstract economic space, rather than physical geographic space. Geographic space is measured in standard 'Euclidean' terms, such that a mile between any two points is equal to a mile between any other two points. However, in the context of growth poles, economic space is the

relevant concept. Economic space is measured in terms of resource cost, such that two sets of points are of equal economic distance only if the transportation costs of movement between both sets of points are equal. Thus, two sets of points might be of equal geographic distance, but of unequal economic distance, or two sets of points might be of unequal geographic distance but of equal economic distance.

Differences between economic and geographic space underlie differences between growth poles and growth centres. As noted above, a growth pole is best viewed as an integrated industrial complex. The linkages between industries within a growth pole are measured in economic space. Thus, a growth pole is concentrated if there is very little economic distance separating the motor industry from ancillary industries, or, in other words, forward and backward linkages are possible with very little transportation cost.

A growth pole that is concentrated in economic space is often concentrated in geographic space as well. When the growth pole is concentrated in geographic space it is termed a growth centre. It should be noted that one particular type of backward linkage is often very important in a geographically concentrated growth centre, that is, consumption expenditures made by employees of the growth pole industry. Given that most types of production are dependent on labour, backward linkages to this resource supply (that is, income) have indirect linkages to numerous other industries (that is, consumption expenditures for retail goods). In essence, growth centres can best be considered as geographically concentrated urban areas.

The growth pole concept, which was thought to solve most development problems, was used extensively in the 1960s. However, it failed to live up to expectations. In fact, in recent years there have been certain reservations voiced regarding the successful application of such a theory. Most of these criticisms relate to controlling the enterprises that are located therein. The fact that even though the pole may be successful in attaining growth, companies may not contribute to their hinterland in

terms of diffusion of economic growth (that is, forward and backward linkages within an economic system leading to increased agglomeration which will increase locational efficiency). The critical issue is whether or not the espoused TRICKLE-DOWN (diffusion of economic growth) prevails.

See also:

development; economic growth; economic regions

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ROBERT LOONEY

guest worker system

Between 1945 and 1975 all West European countries experienced labour shortages, especially in several branches of the manufacturing industry. When alternative sources of labour (agriculture, women) dried up, European governments all resorted to the active organized recruitment of temporary labour both in Mediterranean countries and in certain (former) colonial territories. This system of state-sponsored recruitment of temporary labour was soon known by the euphemistic term 'guest worker system'.

The phenomenon was not new. Starting in the middle of the nineteenth century with the inflow of Irish workers to northern England and later with the trek of east European and Italian workers to Germany, Belgium and France, and also to the northern United States (joined after 1900 by Mexican workers), recruitment of temporary industrial labour became widely known. In these cases, however, the role of the state was negligible. This changed when the United States experienced acute shortages of industrial labour after its entry into World War II. In 1942, the US government concluded an agreement with

Mexico for the recruitment of temporary industrial workers. This Bracero Program lasted until 1964 and brought close to five million Mexican workers to the United States on temporary contracts.

In Western Europe, the main recruiting countries were Belgium, France and Switzerland (from 1945), West Germany (1955), the Netherlands (1960) and Sweden (mid-1960s). Britain mostly relied on spontaneous or privately recruited labour migrants from Ireland and the Caribbean (especially between 1945 and 1962). When the economic crisis of 1973–4 caused the termination of labour recruitment in Western Europe, the number of foreign workers (mostly male) had grown to approximately ten million. In the years since then, immigration into Western Europe from the former recruitment countries continued, mostly through family reunification.

The explanations given by political economists for the rise of the guest worker system can be divided into three groups. The first point of view, supported by neo-classical and Keynesian economists alike (see KEYNESIAN ECONOMICS: NEO-CLASSICAL ECONOMICS), has been the 'push pull model': labour migration is the result of the operation of pull-factors in the countries of destination (labour shortage, high wages) and push-factors in the countries of origin (poverty, unemployment). Orthodox Marxists explained the system from the capitalist need to reconstitute the reserve army of labour and to counteract the falling rate of profit through the import of cheap, flexible, temporary labour of which the reproduction is externalized (see MARXIAN ECONOMICS). The third explanation, which became more prominent as it became clear after 1973 that the crisis did not lead to the massive return of foreign workers, emphasized the segmented nature of the labour market in industrial capitalism and the structural need for migrant labour in certain segments of the labour market.

See also:

migration, international

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HENK OVERBEEK

Gulf War

The Gulf War (1990–1) was a conflict between Iraq and the United States (as the head of a military coalition), sanctioned by resolutions of the United Nations Security Council (UNSC), comprising twenty-eight states. The conflict began with the invasion and occupation of Kuwait by Iraq, on 2 August 1990. Active warfare began on 16 January 1991. After an intensive air assault on Iraq, lasting five weeks, a four-day land attack ensued in which Kuwait and much of southern Iraq were captured as the Iraqi army fled in disorder.

The causes that led to the invasion of Kuwait began with the end of the Iran–Iraq war in 1989. The Gulf Arab states were increasingly suspicious of Saddam Hussein. They had regarded Iraq as an important buffer against Iran's expansionist Islamic revolution.

Gulf War

But with the war ended and Iran much weaker, they were becoming apprehensive of Iraqi intentions, especially as the Saddam Hussein regime kept calling for higher oil prices to finance Iraq's further development.

Because of the low price of oil on world markets, Iraq's oil revenues were inadequate to support its massive programme of development of economic and military power. The country was falling further into debt. Tensions increased rapidly during the first part of 1990. At this time, Kuwait and the United Arab Emirates (UAE) were producing nearly 1.5 million barrels a day more than their ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) quota. As the price of oil fell by more than 20 per cent – from \$19.60 a barrel in February to \$15.60 in June – Iraq's financial position worsened markedly.

In a speech on 17 July, Saddam Hussein stated that something must be done to return things to their natural course. The next day, Kuwait placed its army on alert. President Hosni Mubarak of Egypt attempted to mediate the crisis but to no avail. Iraq moved two armoured divisions (a total of 30,000 men) towards the Kuwaiti border on 24 July, and finally invaded Kuwait on 2 August 1990.

Economic sanctions against Iraq proved unsuccessful in securing a withdrawal. On 7 August, US troops began moving into Saudi

Arabia, a manoeuvre known as Operation Desert Shield, designed to protect Saudi oil reserves from a similar invasion by Iraq. On 29 November, the UN Security Council set 15 January 1991 as a deadline for Saddam to peacefully withdraw troops from Kuwait. Saddam did not comply and coalition forces from thirty-two nations, under the United States' leadership, were launched on 18 January 1991 in Operation Desert Storm. An initial air attack proved successful for the coalition forces, which had essentially gained air control over Iraq and occupied Kuwait within less than a week.

The war directly caused the deaths of 150,000–200,000 Iraqis, made refugees of some four million people of many nationalities, largely destroyed the civilian infrastructure of Iraq and produced an ecological disaster in Kuwait.

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ROBERT LOONEY



Hamilton, Alexander (1755/7–1804)

Alexander Hamilton was one of the earliest proponents of ECONOMIC NATIONALISM. In the *Federalist Papers* and other writings, Hamilton emphasized that the United States needed a powerful central government, in part to protect itself against foreign powers. After becoming the first Secretary of the Treasury in 1789, Hamilton wrote four reports proposing economic policies to increase national economic power, including the 'Report on the subject of manufactures'. In that report, he advocated that the US use various measures, including protectionism and SUBSIDIES, to promote industrialization. This report had little immediate effect but influenced later writers, most notably FRIEDRICH LIST. Daniel Raymond, Henry Carey and others used it to increase popular support for high levels of protectionism in the mid- to late nineteenth century.

In the 'Report on the subject of manufactures', Hamilton criticized Adam Smith's promotion of free trade and limited government, noting that the agricultural protectionism of industrialized countries (see CORN LAWS) limited the United States' ability to benefit from free trade. Because the US lacked the ECONOMIC POWER to open foreign markets, it needed to industrialize to develop an internal market for agriculture. This internal market would also promote national unity by making different regions dependent on one another.

While recognizing the economic benefits of both agriculture and manufacturing, Hamilton emphasized the merits of industrialization, in part to counter the opposing arguments of Thomas Jefferson. Unlike advocates of MER-

CANTILISM, Hamilton supported protectionism only to foster industrialization. He believed that manufacturing would enable the US to utilize its scarce labour better by fostering mechanization, increasing the division of labour, encouraging immigration and promoting the employment of people ill-suited for agricultural work, especially women. Industrialization would also provide greater outlets for entrepreneurs and strengthen the demand for agricultural products.

Hamilton argued for INFANT-INDUSTRY PROTECTION and INDUSTRIAL POLICY to promote industrialization. While stating that nations should attempt to provide themselves with essential items, he noted that protection should be temporary and only granted to new undertakings. Although sometimes characterized as a proponent of AUTARKY, Hamilton opposed prohibitive TARIFFS, preferring industrial subsidies. He noted a variety of ways in which government could promote industry, such as importing skilled workers from abroad, encouraging machinery imports, granting subsidies to people for new areas of business, protecting the rights of inventors and improving commodity transportation.

See also:

ideologies of political economy; Smith, Adam

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Harrod–Domar growth model

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CHRISTINE MARGERUM HARLEN

Harrod–Domar growth model

This model is concerned with an investigation into the conditions required for equilibrium growth with full utilization of labour and capital stock. The model is based on the fixed-coefficients production function: at any level of technology, to produce one unit of output requires a fixed quantity of each input (capital and labour). There is assumed to be no possibility of producing the unit by substituting between inputs, using less of one at the expense of more of the other. With this assumption, it is possible to derive an expression for the growth rate of investment and output needed for growth at full utilization of the capital stock. This rate, Harrod's 'warranted' rate, equals s/k , where s is the proportion of output saved and k is the capital/output ratio.

For full employment of labour to be maintained, output needs to grow at a so-called 'natural' rate, equal to the sum of the growth rate of the labour force n and the growth rate of labour productivity p . Hence for full employment of both factors, we require:

$$\frac{s}{k} = n + p$$

This is the so-called Harrod–Domar condition for equilibrium growth. It implies that such growth, including full use of factors, is very unlikely, as there are no forces tending to ensure that this equation will hold. The model is very rigid, however, and greater flexibilities

in the real world suggest that an approximation to equilibrium growth is more likely in reality.

JOHN CLARK

haute finance

Literally meaning 'high finance' in French, the term *haute finance* has become synonymous with the twenty-four-hour trading of today's global financial system. In POLITICAL ECONOMY, the term was first coined by the Austrian institutional economist KARL POLANYI in his epic work, *The Great Transformation* (1944).

For Polanyi, *haute finance* represented a new and powerful social instrument that ensured there was no major conflagration between the great powers from the end of the Napoleonic Wars in 1815 until the outbreak of World War I. It was a social construct comprising international investment banks, trading companies and influential business families such as the Rothschilds, an international agency linked to the major national banking and finance centres and their stock markets. *Haute finance* was not designed as an instrument of peace but rather, argues Polanyi, ensured peace because a Great War would disrupt the world economy that was vital to the interests that *haute finance* served.

Indeed, Polanyi maintains that it was during the period 1815–1914 that the 'liberal' identification of trade with the promotion of peace appeared. Prior to the emergence of *haute finance*, trade had been warlike in nature – 'an adjunct of the pirate, the rover, the armed caravan, the hunter and trapper, the sword-bearing merchant ...' (Polanyi, 1944: 15). However, once trade became dependent on an international monetary system, it could no longer function in a condition of general war and thus trade became dependent on peace.

Furthermore, *haute finance* ensured international peace because market discipline acted as a powerful moderator on the behaviour of states: 'loans and the renewal of loans hinged upon credit and credit upon good behaviour' (ibid.: 14). The parallels with today's global financial markets and the discipline of EM-

BEDDED FINANCIAL ORTHODOXY (EFO) are apparent.

See also:

institutionalism

Reference

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JASON P. ABBOTT

Havana Charter

The Havana Charter was the first attempt in the post-World War II period to coordinate global economic policy-making. Discussions actually began in 1943, but the bulk of the negotiations took place in London, Geneva and Havana between 1946 and 1948. The Havana Charter contained not only the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), which had been concluded in Geneva in 1947, but also wide-ranging proposals on employment, restrictive business practices, international investment and services. While the GATT (along with rules of conduct on trade and some trade concessions) came into force in January 1948, the rest of the Havana Charter was never ratified, the Truman administration having finally decided that the Havana Charter would not be submitted for ratification to Congress due to its inevitable defeat. Without the leadership of the United States, the Charter stood no chance and the whole plan collapsed.

See also:

liberalism

ALISON M.S. WATSON

Hayek, Friedrich August von (1898–1992)

F.A. von Hayek is one of the leading political economists this century in the classical liberal tradition of SMITH and Hume.

An evolutionary theory of knowledge is the central ingredient in Hayek's political economy. The great utility of free markets arises from the decentralized coordination, via the price mechanism, of highly fragmented and widely dispersed knowledge, and it is this impersonal coordinating process that enables market exchange to take place in complex societies.

Threaded through Hayek's work is the contrast of two opposing intellectual traditions. One is rational-constructivism and the issue of French Cartesianism, which was predominant in nineteenth- and twentieth-century social discourse. It emphasizes the ability of 'rational' human beings to master and control their social environment. The other, the classical liberal tradition (identified with the Scottish Enlightenment through to Hayek himself) is critical of heroic assumptions of rationality and evolutionary in its account of the emergence and survival of complex social orders. It emphasizes the ignorance and fallibility of human beings, and points out that social institutions (for example, money, price, property and rules of private law) are the largely unintended outcomes of human action, not the products of human design.

To Hayek, the market economy is the foremost expression of a *cosmos* or spontaneous order. Complex macro-order emerges in a self-generating, self-organizing fashion from the micro-interactions (buying and selling) of millions of individuals. Here it should be noted that Hayek cleaves to an evolutionary conception of competition, not a neo-classical model of perfect competition (see NEO-CLASSICAL ECONOMICS), which he regards as an utterly unrealistic yardstick for evaluating real-life markets and giving practical policy guidance.

In the Hayekian scheme, the appropriate role of government is not to interfere with the market process which, if left unrestrained, is

heartland–hinterland concept

animated by agents with legally guaranteed (private) property, exercising their full freedom of production and consumption. Rather than trying to direct the market ‘process’, government should limit itself to maintaining and constantly improving the general rules of conduct (especially concerning property and contract) that structure and regulate the ‘order’ of market activities. Hayek, following the Scottish thinkers, places great stress on the (private law) rules that govern market order. As a classical liberal, he believes in ‘liberty under the law’, not an unbounded, anarcho-capitalist *laissez faire*. *Laissez faire* in the market process requires a secure and comprehensive legal framework within which to operate, presupposing a significant, albeit circumscribed, agenda of government action.

Although Hayek concentrates on ‘domestic’ political economy, his most important observation on the international economic order is that, given its market-based institutions of trade, capital and technology flows, it is overwhelmingly ‘spontaneous’; it is not a ‘construct’ of political design and control. This does not come to the fore in static models of the international economy used by economists and political scientists.

See also:

Austrian School; evolutionary economics

Further reading

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RAZEEN SALLY

heartland–hinterland concept

Referring to the region of Eurasia, bounded by the Arctic in the north, Baluchistan and Iran in the south, and extending roughly from Germany to the western border of China, the heartland was characterized as the ‘geographic pivot of history’ by British geographer HALFORD J. MACKINDER in a lecture before the Royal Geographic Society in January 1904. Setting the heartland in opposition to the hinterland – the surrounding territories that enjoy access to the seas – and the insular territories of America and Australia, Mackinder and other students of GEOPOLITICS (for example, A. Mahan and N. Spykman) sought to explain broad patterns of international relations in terms of the strategic implications of geographical constants. However, technological developments such as air transportation and global telecommunications, rendered many of their observations obsolete. In the context of increased GLOBALIZATION and regional integration, political geography has enjoyed some renewed interest in the late 1990s.

See also:

geopolitics

JAMES W. DAVIS

Heckscher, Eli (1879–1952)

Eli Heckscher was born in Stockholm and studied economics and history at Uppsala University from 1897. He was awarded a doctorate in 1907 and in 1909 became Professor of Economics and Statistics at Stockholm University, a position he held until 1929 when he was appointed Chairman of the Institute of Economic History. He remained as chairman of the institute until his retirement in 1945.

Heckscher’s contribution to the neo-classical theory of international trade comes entirely from a paper he published in 1919, entitled ‘The effects of foreign trade on the distribution of income’. In this paper, he stated the

hypothesis that countries will export those commodities which require relatively more of the factors of production that those countries have in abundance. He also argued that international trade would result in both relative and absolute FACTOR PRICE EQUALIZATION across countries, thus showing that free trade was a substitute for free international factor mobility. Heckscher's arguments were largely implicitly derived from a neo-classical perspective with its underlying assumptions of free trade, perfect substitutability and constant returns to scale. His student, Bertil Ohlin, later expanded on Heckscher's hypotheses using Cassel's GENERAL EQUILIBRIUM analysis. PAUL SAMUELSON completed the neo-classical model by formally proving Heckscher's relative and absolute factor price-equalization hypothesis. The resulting, highly formalized model became known as the HECKSCHER–OHLIN–SAMUELSON (HOS) MODEL OF TRADE.

Heckscher is better known as an economic historian and, in particular, for the publication of *Mercantilism* in 1931. Heckscher viewed MERCANTILISM, as Schmoller did, not as an economic theory but as an ideology in which economic theory and policy were used to maximize the power of the state. For Heckscher, mercantilism could be analysed as a system of ideas, unrelated to specific economic situations and institutions. Heckscher attempted to steer a difficult course between an absolutist interpretation of mercantilism, in which the logical flaws in its theoretical principles are seen as the cause of its downfall, and a relativist interpretation, in which mercantilist policies are viewed as inherently rational given the goals of the system. However, he was criticized for failing to show an unambiguous link between mercantilist theory and mercantilist policies. Despite this and other criticisms, Heckscher's book remains a definitive work on the subject.

Heckscher's strong allegiance to liberalist ideology is evident throughout *Mercantilism* and many of his other publications. It is also evident in the stances he took on the many governmental boards on which he sat. His allegiance was at the price of several personal

and professional friendships, including that of his former student Bertil Ohlin.

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SIOBHAIN McGOVERN

Heckscher–Ohlin–Samuelson (HOS) model of trade

The Heckscher–Ohlin–Samuelson (HOS) model of trade explains comparative cost differences across countries on the basis of differences in relative FACTOR ENDOWMENTS. This explanation was first put forward by ELI HECKSCHER in 1919, and was introduced to the English-speaking world by his pupil, Bertil Ohlin, in 1933. Both Heckscher and Ohlin viewed relative factor endowments as one explanation of COMPARATIVE ADVANTAGE, others being ECONOMIES OF SCALE and demand factors. However, the relative factor endowments explanation has the advantage of being easily incorporated into the neo-classical or pure theory of international trade (see NEO-CLASSICAL ECONOMICS). While Heckscher and Ohlin initiated research into the impact of factor endowments on international trade patterns, PAUL SAMUELSON played a major role in incorporating the factor endowments explanation into the neo-classical model, and also in subsequent modifications and extensions to the model.

The HOS model predicts that in a two-country model where Country A is relatively capital abundant and Country B is relatively labour abundant, Country A will have a comparative advantage in the production of commodities which use relatively more capital

and Country B will have an advantage in the production of commodities which use relatively more labour in their production processes.

Along with the assumptions underlying the principle of comparative advantage, there are a number of additional assumptions which must hold if trade patterns are to be determined solely by relative factor endowments. Both countries must have identical preferences for traded and non-traded commodities. Both labour intensive and capital intensive commodities must be produced under constant returns to scale. A commodity which is labour (capital) intensive in Country A must also be labour (capital) intensive in Country B. A commodity which is labour (capital) intensive must remain so regardless of level of production and relative factor costs.

During the 1940s and 1950s, attempts were made to extend HOS into a multi-country, multi-commodity, multi-factor model. This necessitated the introduction of a high degree of mathematical complexity into the standard model of trade which, along with the limiting assumptions, drove a wedge between the standard theory and real trade-patterns. However, a few important corollaries to the standard theory were made at this time. Stolper and Samuelson (1941) used HOS to show that a tariff, by limiting imports of labour (capital) intensive commodities, can benefit returns to labour (capital) in the country. This highlights the political dimension of international trade-patterns. Samuelson (1948, 1949, 1951, 1953) derived the FACTOR PRICE EQUALIZATION theorem which predicts that free trade will equalize relative and absolute factor prices across countries. Specialization according to factor abundance causes demand for the abundant factor to increase relatively more than demand for the scarce factor. The price of the abundant factor rises, while the price of the scarce factor falls. In the trading partner, the same factor price changes are observed. These factor price movements continue until factor prices are equalized in both countries. Free trade, therefore, should lead to greater convergence across trading countries. Rybczynski (1955) showed that an increase in the growth

of one factor of production will result in a decrease in the production of the commodity which uses the other factor more intensively.

The HOS model was not empirically tested until 1951, by WASSILY LEONTIEF. Leontief found that United States exports for 1947 were labour-intensive, despite the US being highly capital-abundant. This, and other subsequent tests, highlighted what Heckscher and Ohlin had pointed out several decades earlier, namely that relative factor abundance is only one of a number of different explanations for comparative advantage. The HOS model cannot explain trade between industrialized countries, all of which would be characterized as capital-abundant. Only a little over one-third of world trade occurs between countries with very different factor resources. The HOS model also has a problem with intra-industry trade (see TRADE, INTER-INDUSTRY AND INTRA-INDUSTRY). In the HOS model, by definition countries cannot import and export commodities from the same industrial group. Intra-industry trade accounts for between 60 per cent and 80 per cent of trade in industrial countries. Given the failure of the HOS model to explain a large number of different types of international trade patterns, it is recognized as only one of a number of explanations for comparative advantage. Others include economies of scale, product differentiation, TECHNOLOGY TRANSFER and the PRODUCT-CYCLE MODEL.

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SIOBHAIN McGOVERN

hedge funds

While there is no legal or universally accepted definition of a hedge fund, they can be regarded most simply as an unregulated form of mutual fund which caters exclusively to wealthy individuals and institutions, and which makes extensive use of alternative investment techniques and instruments. By structuring themselves as unregistered private offerings or chartering themselves offshore, hedge funds are exempt from most national securities regulations. On the liabilities side, hedge funds are characterized by higher fees (typically 1–2 per cent of net assets and 20 per cent of annual returns) and higher minimum investment requirements (typically US\$1 million). As a result, hedge funds cater solely to wealthy and risk-tolerant individuals and institutions. On the asset side, the unregulated nature of hedge funds enables them to employ investment techniques and instruments not available to conventional INSTITUTIONAL INVESTORS, such as leveraging (speculating with borrowed assets, also known as gearing), DERIVATIVES (that is, options, futures and swaps), short-selling (profiting from a decline in an asset's price) and directional investment strategies (speculative moves that are not 'covered' or hedged against).

See also:

mutual funds; portfolio investment

ADAM HARMES

hedging

Hedging is the attempt to offset a future loss in one commodity, financial instrument or currency by purchasing another, the behaviour of which is expected to have a contrary effect to that of the first. DERIVATIVES such as options can be used in this way and their advocates argue that they serve a useful function by allowing the transfer of risk to speculators from risk-averse purchasers of hedges. One could say that the growth of hedging signifies a privatization of risk-management where states no longer seek to stabilize commodity prices, interest rates or exchange rates.

TONY PORTER

hegemonic cycle

A hegemonic cycle refers to a relatively well defined temporal cycle in the stability of the international economy, in particular, and in peaceful international relations in general. It is postulated by two main theoretical perspectives – the modern WORLD-SYSTEMS THEORY advanced by IMMANUEL WALLERSTEIN, and the long-cycle school of world leadership of George Modelski (see LONG CYCLES) – that stable structures of international relations result from the dominance of a hegemonic state which imposes order on the system. It is argued that it is in the interest of a predominant power actively to shape the features of the system to its advantage through administering and maintaining rules governing international relations. However, hegemony is short-lived and as the predominant state no longer possesses the requisite material resources to enforce the rules of international relations, the system reverts to instability until a new hegemon can establish a new order. Consecutive cycles of approximately 100 years have been identified, under the leadership of the Netherlands, Britain and the United States of America.

While the theoretical approaches share this basic premise, there are notable differences. The modern world-systems analysis views the

hegemonic decline

international system as one composed of a hierarchy of powers whose strength depends primarily on technological advantage and productive capabilities that provide the wealth necessary for other sources of power. This is translated into overall stability for the system, for a major mechanism that has provided the world economy with political stability has been the concentration of military strength in core states, and in the hegemonic state in particular. Relations among core states are regarded as cooperative, but with underlying mercantilist tensions. During periods where there is a high concentration of economic and military power in one state, there is stability. However, the hegemonic state declines because other core states innovate and surpass its technological superiority in the productive sphere. Such newly rising stars of the international economy seek to redefine the rules, which gives rise to a period of instability.

The long-cycle school has developed a more refined methodology to identify cyclical patterns in international relations, known as the study of 'chronomacropolitics'. The patterns of major power wars are unquestionably the focal point of long-cycle theory and the lead state is identified as possessing superior military power with a global reach. The cycle begins following the peace-settlement of a global war, which creates a high demand for leadership. This is satisfied as a world power emerges, assumes the leadership of the international system and legitimates that position. This is followed by a period of delegitimation and the leader is finally met by a military challenger in the final stage of deconcentration, resulting in another global war which renews the cycle. The significance of this theory for IPE is that such states generally favour free trade.

The analysis of historic cycles can be criticized as historicist (see HISTORICISM) and as seeking general 'laws' of motion in the international system. Moreover, neither of these approaches emphasizes the provision of public goods by hegemonic states, nor the complex mechanisms of legitimation. These are elaborated in the HEGEMONIC STABILITY THEORY of CHARLES KINDLEBERGER. Rather,

these are macro-theories which emphasize the initiation and change of structures in the international system.

See also:

hegemonic decline; hegemonic stability; hegemonic transition; hegemony; hegemony, US

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JARROD WIENER

hegemonic decline

The evolution of the modern international system has been shaped by a succession of hegemonic states, each rising and falling in a cyclical fashion. Examples include Great Britain in the nineteenth century and the United States in the twentieth century. Some scholars have associated the presence of a single hegemonic state with periods of international stability and economic openness. Combining superior political, economic and military resources, hegemonic states have the rare capacity to invest in the COLLECTIVE GOODS necessary to create and sustain a stable international order. They do so not out of altruism, but because the benefits flowing to the hegemon from a well functioning international order exceed the costs of contributing to that stability.

In the long-run, however, HEGEMONY is self-liquidating. Under a hegemonic order, lesser powers tend to experience higher rates of economic growth than the hegemonic state itself. Over time, this allows competing states to challenge the hegemon's pre-eminent status. The hegemon experiences relative decline, eventually reaching a stage where it is neither

willing nor able to exercise continued leadership on behalf of a stable international order.

Three major factors work to narrow the power gap between the hegemon and other states:

- 1 Burdens of leadership: Paying a disproportionate share for the creation of various international collective goods, the hegemon bears burdens of leadership that other states forego. Allies, for instance, tend to free-ride on the relatively greater defence-spending borne by the hegemon (see FREE RIDER PROBLEM).
- 2 Overconsumption: With a more mature economy than other states, the hegemon tends to experience a higher ratio of consumption to investment. As other societies invest a larger proportion of their income, they also experience higher long-term rates of ECONOMIC GROWTH.
- 3 Technological diffusion: Although the power of the hegemon often rests in part on its mastery over leading technologies, technological knowledge is difficult to harness and control. Technology diffuses rapidly, allowing other states to imitate the technical prowess of the hegemon without paying the costs that went into creating new knowledge in the first place.

Hegemonic states can seek ways to extend their power advantages over other states, although the long-run tendency toward decline is difficult to arrest entirely. As their power declines, hegemon experience a growing gap between dwindling resources and static commitments. A hegemonic state can close this gap by casting off peripheral commitments and the costs that go with them, though at some damage to its international influence. Alternatively, a hegemon can extract resources from its own society at a higher rate, devoting a larger share toward shoring up its international position or squeezing consumption in order to increase the rate of investment. Each route involves difficult trade-offs.

A variety of consequences may accompany a period of hegemonic decline. A declining

hegemon may become less willing to bear the burdens of leadership over time and may instead begin to engage in more narrowly self-regarding behaviour. This shift from benign to malign hegemony can serve to undermine rather than reinforce systemic stability. Rising powers may use their growing resources to challenge the hegemon's ability to set the rules and norms of the international order, seeking to overturn the hierarchies of prestige, territory and rewards. If the hegemon responds to such a challenge defensively, the probability of a hegemonic war will increase, pitting the existing hegemon against a rising aspirant. In general, the risks of international instability grow as the leadership capacity of the hegemon diminishes.

See also:

hegemonic cycle; hegemonic stability theory; hegemonic transition; hegemony

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DAVID SKIDMORE

hegemonic stability

Hegemonic stability is an analytic concept that posits a relationship between the presence of a single, dominant state and an open, liberal or 'stable' international economy. It is based primarily on the historical experience of Britain in the nineteenth century and its broad parallels to the position and leadership role of the United States in the twentieth century.

As Britain rose to a position of economic

dominance following the INDUSTRIAL REVOLUTION and the Napoleonic wars, it dismantled its protectionist system, climaxing in the repeal of its CORN LAWS in 1846. Other states soon followed suit, ushering in a remarkable period of international free trade. Britain also managed its financial markets in a way that led to unprecedented CAPITAL MOBILITY and, under a near universal GOLD STANDARD, stable exchange rates. As Britain's international economic dominance slowly waned, openness and stability deteriorated: Europe returned to protection following Germany's 'tariff of iron and rye' in 1879 and the gold standard, despite efforts to resuscitate it, collapsed during World War I.

Observing increasing strains in the then open and stable international economy and a similar decline in the political and economic dominance of the United States, CHARLES KINDLEBERGER, ROBERT GILPIN and other analysts writing in the early 1970s began to study the similarities between the *PAX BRITANNICA* and *PAX AMERICANA*. Like Britain, the United States had dominated international goods and financial markets, and helped lead other states toward international economic openness and stability. And like Britain, America's decline was producing increasing demands for protectionism, culminating in a series of VOLUNTARY EXPORT RESTRAINTS (VERs) and ORDERLY MARKETING AGREEMENTS (OMAs), and more nationalistic monetary and financial policies, leading to the end of the Bretton Woods monetary system in 1971 (see BRETTON WOODS SYSTEM). Analysts began to predict that the decline of the United States might precipitate a collapse of the international economy similar to the GREAT DEPRESSION of the 1930s.

Often referred to as the 'theory of hegemonic stability', the research programme that grew from the historical parallels between Britain and the United States is more accurately characterized as a collection of theories united by a common focus on the relationship between the international political or economic structure and the openness or stability of the international economy. Although there are

many subtle and important differences within each, there are two primary analytic themes in the hegemonic stability literature.

One theme focuses on the provision of certain PUBLIC GOODS that are necessary for the effective functioning of an international economy, including a broadly accepted medium of exchange and store of value, adequate liquidity and effective PROPERTY RIGHTS in cross-border transactions. In the absence of any world government able to provide these services authoritatively, international stability arises only when there is a 'privileged group' that benefits sufficiently to offset the costs of producing the required public goods. Early writings on this theme, especially those of Kindleberger, posited that collective action problems between sovereign, independent countries would be sufficiently severe that only a single, dominant state would form such a group. Later analysts demonstrated theoretically, but not empirically, that privileged groups of more than one state could exist, undercutting the research programme's focus on hegemony. The effective management of the international monetary system since the late 1970s (and especially following the so-called PLAZA ACCORD of 1985 that restabilized exchange rates after an extended period of BENIGN NEGLECT) suggests that collective leadership may be possible.

A second theme stresses that free trade, despite the teachings of economists, is not necessarily the optimal policy for all states. States may possess goals other than maximizing national wealth, or the assumptions that underlie the so-called law of COMPARATIVE ADVANTAGE may not hold. In this view, states occupy different positions within the international economic structure and, in turn, possess competing preferences over trade policy. It is hypothesized that the openness or closure of the international economy is the product of strategic bargaining between a free-trade oriented hegemon and other states, at least some of whom are more inclined toward protection. In short, hegemons are expected to lead other states to modify their policies and adopt free trade. Once the hegemon declines, and can no

longer influence others to the same extent, countries are expected to return to policies of protection.

Much of the scholarly debate about hegemonic stability has focused on the instruments of international leadership. For some, the hegemon is benevolent and leads by unilaterally providing public goods desired by all states. For others, the hegemon is coercive, using its leverage to alter the incentives of other states so they either contribute to the provision of the public good or alter their policies toward greater free trade. For some, the hegemon exercises its market power to produce desired ends. For others still, the hegemon uses ideas, ideology and discourse to influence public opinion and the political agenda in other countries so as to determine what are legitimate and illegitimate policies and forms of political behaviour; in this perspective, the hegemon influences the general climate of opinion and beliefs, and thus the policies of foreign countries (see HEGEMONY, BLOC).

The empirical evidence in support of HEGEMONIC STABILITY THEORY is, at best, mixed. Few conclusive tests of the theory have been undertaken. More important, the continuing stability and openness of the international economy, embodied in the success of the URUGUAY ROUND of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), concluded in 1994, has called the presumed parallel between the end of the *Pax Britannica* and *Pax Americana* into question. Despite America's relative decline, the liberal international economy is still reasonably robust. Indeed, states are now beginning to tackle a broader set of issues, including international trade in services, and to establish new rules of NATIONAL TREATMENT FOR FOREIGN DIRECT INVESTMENT (FDI).

The most important contribution of scholars working on hegemonic stability has been to reveal the international political foundations of the international economy. Neither stability nor economic openness is a naturally occurring phenomenon. Rather, they are the product of political choices made by powerful states. Focusing on the role and influence of Britain

in the nineteenth century and the United States in the twentieth century brings these political foundations into sharp relief.

See also:

hegemonic cycle; hegemonic decline; hegemonic transition; hegemony, bloc

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DAVID A. LAKE

hegemonic stability theory

Hegemonic stability theory asserts that a single element of international structure – the presence or absence of a predominant state or hegemon – is the primary determinant of collective political-economic outcomes at the international level. The theory commonly is stated as an association between the presence of a hegemon and a relatively open international system (as, for example, in the cases of mid-nineteenth-century Britain and the United States following World War II), along with the obverse association between absence of a hegemon and a relatively closed international system (as, for example, in the cases of the inter-war period and, according to some analysts, the late twentieth century).

While such a concise statement of the theory captures its essence, variations of hegemonic stability theory exhibit important differences in their definitions, assumptions and implications. These differences are, in fact, sufficiently substantive to result in the identification of one major branch of hegemonic stability theory (attributable to political scientists ROBERT GILPIN and Stephen Krasner) with the realist or neo-realist tradition of INTERNATIONAL RELATIONS (IR) (see NEO-REALISM; REALISM) and of another branch (attributable to economic historian CHARLES KINDLEBERGER and, later, to political scientist ROBERT KEOHANE, who named the theory) with the neo-liberal or institutionalist tradition (see INSTITUTIONALISM; NEO-LIBERALISM).

One useful way to organize the distinctions between the variations of hegemonic stability theory is to use the two key words of the name itself: (1) differences in definitions and measurement of *hegemony* and (2) differences in assumptions about what exactly a hegemon provides to the international system, for example, *stability* or openness. These two areas of difference carry important implications for the nature of the theorized relationship between the hegemon and other states, or for why hegemonic and non-hegemonic states play their particular roles in the international system.

Defining, measuring and dating hegemony

Disagreement among IR theorists about the most appropriate or relevant definition of hegemony has limited consensus on the results of numerous efforts to test the theory empirically. On the one hand, very stringent definitions of hegemonic status render empirical testing beyond simple case studies impossible, because they produce such a small number of historical cases of hegemony. Most theorists acknowledge two cases (nineteenth-century Britain and the United States following World War II) or, at most, three (adding the seventeenth-century Dutch Empire); some recognize only one, usually the United States. On the other hand, lax definitions, such as routinely defining the largest or most powerful state as hegemonic, strip the theory of any empirically testable implications, since the international system would never lack a hegemon.

Some scholars have used *absolute* measures of size to divide hegemonic from non-hegemonic states: GROSS NATIONAL PRODUCT (GNP), volume of international trade, and volume of international borrowing and lending are among the measures used. Other scholars have emphasized hegemony as a *relative*, rather than an absolute, concept and have focused on a state's share of total world GNP or share of total international trade. Still others have claimed that performance-based measures, such as a state's ability to exert control over markets and over other states' behaviour, provide more relevant metrics of hegemonic status. This last approach, however, introduces additional subjectivity into the determination and risks making hegemonic stability theory tautological (that is, a country that can dictate the nature of the international system is a hegemon, while one that cannot is not).

Proponents of stringent definitions of hegemony typically require that states exhibit predominance simultaneously in several key ISSUE AREAS (usually some combination of military POWER, political power, ECONOMIC POWER, participation in trade and participation in international finance) to attain hegemonic

status. Proponents of less stringent definitions focus on one or two issue areas and often argue that predominance in other areas usually follows. Also at issue is the geographic scope required for hegemony: after all, even the military, economic and political predominance of the post-war United States was limited largely to the capitalist world.

These central problems in defining hegemony (is it absolute or relative? in how many issue or geographic areas must a state predominate?) contribute to theorists' diverse conclusions about precisely which countries have been hegemons and the precise dates during which each reigned. Dates acknowledged for the two most commonly accepted cases, Britain and the United States, differ widely, with important implications for empirical verification of hegemonic stability theory. If one judges that British hegemony ended around 1880, a period of relative openness, then the British case supports the theory. If, however, one sees British hegemony as having lasted until 1914, the outbreak of World War I, then the case is much less supportive. Similar questions surround the US case. Some analysts claim US hegemony already had been seriously eroded by the late 1960s, as evidenced by the strains on the US-dominated BRETTON WOODS SYSTEM OF FIXED EXCHANGE RATES, while others acknowledge the continuing hegemony of the United States well into the late 1990s, pointing to the dissolution of the other post-war SUPERPOWER, the Soviet Union.

What do hegemons provide?

The neo-realist and neo-liberal branches of hegemonic stability theory differ in their assumptions about exactly what it is that hegemons provide which changes the fundamental outcome of the international system. In the neo-realist tradition, states pursue primarily political power (with varying degrees of military emphasis) and economic power serves more as a means than an end. The role of economic openness (for example, FREE TRADE) in a state's preferences varies with that state's place in the international system, and hege-

mons are argued to prefer more openness than do non-hegemonic states. A hegemon's predominant position allows it to impose the relatively open international system it prefers which, in turn, facilitates the hegemon's further pursuit of political power. This imposition of openness can involve more or less COERCION. At the 'benevolent' end of the spectrum of possibilities, the hegemon may simply absorb some of the costs of openness that otherwise would fall on other states, provide enhanced market-access to other states that comply or seek to create belief systems that link openness and political-economic success. At the 'coercive' end of the spectrum lie military threats, economic sanctions or contingent foreign aid decisions (see SANCTIONS, ECONOMIC). In sum, the neo-realist branch of hegemonic stability theory asserts that a hegemon imposes relative economic *openness* because such policies suit the hegemon's own pursuit of political power, given its place in the international system, and that other states, whose preferences may devalue openness, must be bribed, coerced or otherwise convinced to play their role in such a system. The main weakness of neo-realist models of hegemonic behaviour is the lack of two clear theoretical linkages: the first between hegemonic status and a preference for openness, and the second between non-hegemonic status and a preference for closure. Several possible theories have been suggested for each, but most have been somewhat *ad hoc* and have yet to receive convincing empirical support.

In the neo-liberal branch of hegemonic stability theory, the hegemon provides the international system with economic stability or ECONOMIC LEADERSHIP rather than openness. The distinction is crucial because stability or leadership almost certainly exhibits important characteristics of 'publicness', while the openness emphasized by neo-realists may or may not be a PUBLIC GOOD. A good is public if characterized by non-rivalry in consumption (that is, more than one individual can consume the same unit of the good) and non-excludability (that is, once produced, the good is readily available to all, not just to those who pay for it). The classic example is national

defence. Public goods create FREE RIDER PROBLEMS because each actor faces an incentive not to contribute to paying for the good's provision, hoping that others will pay and still allow the non-contributor to enjoy the good.

Providing international economic stability or leadership can include such public goods as financial liquidity, exchange-rate management, international law and property rights, and macro-economic policy coordination. Most, if not all, states benefit from such goods, but the free rider problem may result in the goods being under-provided. A hegemon, however, may itself benefit sufficiently from these public goods that it will choose to provide them, even if other states free-ride. Charles Kindleberger argued, for example, that both nineteenth-century Britain and the United States after World War II played such a role, but that international stability and leadership were in short supply during the 1920s and 1930s when joint Anglo-American efforts to provide them failed – because British hegemony had waned while the United States was not yet ready to shoulder hegemonic responsibilities. The neo-liberal version of hegemonic stability theory often is characterized as benevolent because the hegemon bears a disproportionate share of the costs of providing public goods that benefit all, in contrast to the more coercive neo-realist version in which the openness provided benefits the hegemon but not necessarily other states.

Criticisms and refinements

The differences between the neo-realist and neo-liberal branches of hegemonic stability theory have contributed to criticism of the theory by creating confusions and disputes in the literature. For example, several analysts have criticized hegemonic stability theory in general by arguing that economic openness or free trade (that is, what the hegemon provides in the neo-realist version) does not exhibit the non-rivalry in consumption and non-excludability required for 'publicness' (the key logical step in the liberal institutionalist but not in the neo-realist version of the theory).

Other critiques stem from empirical studies in which considerations beyond the presence or absence of a hegemon (in fact, beyond international structure more generally) have been found to influence countries' foreign economic policies. Examples include domestic and international business-cycle conditions, domestic policy-making institutions (for example, executive versus legislative control over trade policy), domestic political-economy considerations (for example, patterns of suffrage and factor ownership) and governments' desires to credibly commit themselves to future courses of policy (for example, the moves toward free trade within both the EUROPEAN UNION (EU) and the NORTH AMERICAN FREE TRADE AGREEMENT). Both the neo-realist and neo-liberal versions of hegemonic stability theory take the state as a rational unitary actor, seeking (political) power, (economic) wealth or some combination thereof. But hegemons – even given the tiny number of cases – differ widely in the domestic structures of their politics and economies, and much modern work in international political economy (IPE) suggests that these differences are important determinants of international economic policy, especially TRADE POLICY.

The two most important theoretical criticisms of hegemonic stability theory are most relevant to the more fully articulated neo-liberal version. Neither criticism claims to invalidate the theory, but taken together they circumscribe both its usefulness and its empirical verifiability. The first criticism uses an insight from economics, in particular from MANCUR OLSON's *The Logic of Collective Action* (1965), to conclude that a single state willing to tolerate other states' free-riding (that is, a neo-liberal hegemon) may not be necessary for public goods such as international stability and leadership to be provided. Olson demonstrated that, in a public-good free-rider-prone situation, a small group of relatively large actors (called a 'privileged' or 'k-group', where $k > 1$) may be able to act jointly to provide the public good – if each benefits sufficiently from its provision and recognizes that, should any one of them attempt to free-ride, the good

would vanish. By making hegemony unnecessary for international stability, the k-group argument tempers the 'drama' of hegemonic stability theory by undermining its implications concerning the potentially disastrous effects of hegemonic decline. For example, even though attempts at joint Anglo-American leadership failed during the inter-war period, perhaps some degree of coordinated leadership among, say, the United States, Germany and Japan could support (or has been supporting – depending on how one judges the current status of US hegemony) adequate international public goods. The k-group argument also complicates the already problematic task of testing hegemonic stability theory empirically, because k-groups admit a second circumstance in which we might observe the international stability and leadership that the pre-k-group theory associated uniquely with hegemony. For example, perhaps US hegemony has declined, creating a *tendency* for the supply of public goods previously provided by the hegemonic United States to disappear, but, if a k-group exists, stability and leadership might persist, albeit from a different source. Such a result does not invalidate hegemonic stability theory so much as make it less vital or interesting.

The second, related, theoretical development has a similar effect. Robert Keohane, among others, has argued that hegemons do what they do not single-handedly but by facilitating construction of international regimes which, in turn, affect the international system through their norms, rules and expectations. In this view, the role of the hegemon shifts somewhat: from one of directly providing public goods, it becomes one of supporting the creation of international regimes and helping strengthen those regimes. This shift presents two further difficulties for testing hegemonic stability theory. Without a deterministic theoretical link between the presence of a hegemon and the presence of strong regimes, separating the effects of the two phenomena becomes problematic. For example, should the relative success of international macro-economic policy during the early post-war period be attributed to US hegemony, to the strength of the Bretton

Woods exchange-rate regime or to the former operating through the latter? The second empirical problem introduced by regimes stems from their persistence. If regimes rely on hegemons for their construction, but may outlast their builders, then the dates at which empirical researchers should expect to find substantial shifts in the nature of the international system become less clear than is suggested by the more simplistic versions of hegemonic stability theory.

See also:

governance; liberalization of trade; mercantilism; multilateralism; optimal tariff; *Pax Americana*; *Pax Britannica*; political economy; prisoners' dilemma; rational choice; regime theory; regionalism; trade blocs

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BETH V. YARBROUGH

hegemonic transition

Hegemony exists when one powerful state dominates all other states. A transition occurs when an established hegemon is replaced by a rising challenger with both the requisite relative material strength and the will to assume the hegemonic mantle. An excellent historical example is the transition of the early twentieth century. At the turn of the century Great Britain, in relative decline, was challenged by both Germany and the United States. On the conclusion of World War II, the United States assumed the role of hegemon. Hegemonic transitions are discussed in terms of their causes and their effects.

The most basic and agreed upon cause of hegemonic transitions is what is referred to as the 'law of uneven growth'. This term, which is associated with ROBERT GILPIN (and, earlier, with V.I. LENIN), conveys the notion that different states' domestic economies grow at different rates. Gilpin argues that no matter how great the initial difference in magnitude between the material strength of the hegemon and its closest competitor, uneven growth will eventually make a transition possible. For example, despite the tremendous economic power of the United States in 1950, Japan had become a rising challenger in the 1970s and 1980s. The relatively higher rates of growth in the Japanese economy helped to close the gap between it and the United States. The uneven growth argument is based on the further claim that ECONOMIC POWER is highly fungible, and convertible into military and/or political power. It is when rising economic power is converted into military and/or political power that a transition may take place.

There are two important effects of hegemonic transitions. The first major effect of hegemonic transitions is destabilization. Stability in the international economic order is thought to be associated with hegemony. Consequently, periods of transition are argued to be less stable than those of hegemonic dominance. The second major effect of hegemonic transitions is hegemonic war. Hegemo-

nic war is a predicted effect of hegemonic transitions because rising powers are argued to have rising goals or demands. They may have these demands because of the expanding needs of a growing populace and economy (such as for resources) and/or because the anarchic nature of the international system requires that states expand when they can, assuming that expansion enhances security. War occurs when the established hegemon resists the rising challenger's new goals (and may be initiated by either the rising challenger or the established hegemon). A classic case of hegemonic war was the clash between the rising German challenger and the established British hegemon that culminated in World War I. Germany desired recognition of its status as a world power, it sought to break the stranglehold of British naval supremacy and to expand its territory in Europe. When the British sought to defend themselves against these German aims, hegemonic war became highly likely.

See also:

hegemonic cycle; hegemonic decline; hegemonic stability theory; long cycles; war cycles

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JASON DAVIDSON

hegemony

The term 'hegemony' refers to the occupation of a dominant position within any system. Hegemony within the international political economy, as will be seen from other entries in this encyclopedia, has been employed within at

least two distinct theoretical perspectives. Realist views of hegemony identify cycles of rise and decline of dominant powers throughout the history of the international system (see **REALISM**). They also attribute international stability to the existence of an effective hegemon within the international system and, if the hegemon is broadly benign, the construction of international institutions that can serve the general good. Marxist views of hegemony are far less benign – identifying such hegemony with the exploitative position enjoyed and maintained by those states that are economically and politically dominant or, in the neo-Gramscian version (see **NEO-GRAMSCIANISM**), the dominant groups that are able to control the economic/political systems and also to mould the systems of belief that underpin the social, economic and political order (a 'hegemony bloc').

See also:

hegemonic cycle; hegemonic stability theory; hegemonic transition

R.J. BARRY JONES

hegemony, bloc

The idea of a hegemonic bloc, also known as an historic bloc or hegemonic class, originates in the writings of ANTONIO GRAMSCI who referred primarily to an ideological hegemony of a ruling class in legitimating its position of authority in **CIVIL SOCIETY**. Hegemonic classes exercise leadership in a domestic context through a combination of coercion and consent. Although the coercive apparatuses of the state are always present, the ruling class gains legitimacy – the right to rule – by providing those over whom it rules immediate material benefits and by maintaining an intellectual and moral leadership role as the purveyors of a dominant **IDEOLOGY**. As long as the ruled identify with the norms and ideas that underlie the political order and believe these to be just, the exercise of coercion by the hegemonic class

hegemony, US

is tolerated. However, when the hegemonic class loses its ideological hegemony and coercion no longer enjoys the cloak of authority, a counter-hegemonic bloc emerges to contest political power, which results in a war of position.

The Gramscian notion of hegemony is not identical to governmental power, the latter being based on Weberian rational-legal authority which pertains in constitutional frameworks. Rather, hegemony refers to the position of leading groups that exercise ideological leadership. Thus, some branches of international political economy (IPE) have equated the concept of the hegemonic bloc with an international normative-ideological capitalist superstructure which gives a certain class a privileged position, not only nationally but also internationally. That is, a hegemonic class influences the pattern of production in the core states and co-opts elites from the periphery to connect states into a world economy. An internationalized class, composed of an alliance of historic blocs within the various states, manipulates state policies such that these also become internationalized, or harmonized, to serve the interests of the transnational hegemonic bloc. The dominant mode of production is sustained by transnational norms, rules and institutions which permeate states at both the level of government and civil society.

The implications of this theory for IPE are numerous. First, it challenges state-centric models by suggesting that the true causal agent for state policy is not state interest, narrowly defined, but is rather the dominant class within it. This theory also challenges classical liberal theory, which discounts the role of the state, by suggesting the existence of a transnationalized class underpinning the world economy. However, one could question the extent to which this theory represents an advance upon, as opposed to a refinement of, Marxist ideas of international classes and state behaviour reflecting and protecting the interests of its dominant classes. Its novelty is the postulation of the harmonization of state policies both internationally and domestically as following from the internationalization of classes and

modes of production, rather than conflict (as can be found, for instance, in the writings of LENIN).

See also:

Cox, Robert W(arburton); neo-Gramscianism

JARROD WIENER

HEGEMONY, GRAMSCIAN *see* hegemony, bloc

hegemony, US

Since World War II, the United States has been the predominant power in the international political economy. The scope and significance of this power – often referred to as ‘HEGEMONY’ – has provoked considerable debate. There has been a great deal of disagreement concerning the extent of US hegemony and its impact on the rest of the world.

One useful approach to the concept of hegemony derives from Susan Strange’s notion of ‘STRUCTURAL POWER’ in the four key areas of the world political economy: security, production, finance and knowledge (Strange, 1988). After World War II, the United States had clearly ascended to a position of historically unprecedented leadership in all of these areas and constructed regimes designed to further US interests. The complex of post-war institutions designed at Bretton Woods and subsequent conferences included the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) and INTERNATIONAL MONETARY FUND (IMF), and International Bank for Reconstruction and Development (IBRD) or WORLD BANK. By laying the basis for the progressive LIBERALIZATION of trade and financial markets, and by establishing the US dollar as the key currency and *de facto* anchor of the international monetary regime, the BRETTON WOODS SYSTEM conferred enormous privileges on the United States. US policy-makers were able to pursue an independent budgetary policy, while

at the same time implementing strategies of aid and trade designed to promote the post-war reconstruction of Europe and Japan and, more generally, to sustain both domestic and global economic expansion and stability. The post-war international political economy also reflected the great military power of the United States. Even after its initial monopoly of atomic weapons was ended, the United States remained at the hub of alliance systems in Europe and Asia that had been designed to contain challenges from socialist countries.

In 1971, President Richard Nixon unilaterally abrogated the Bretton Woods monetary system by renouncing the convertibility of US dollars to gold and implementing modest protectionist policies. Many scholars asserted that the collapse of the Bretton Woods system resulted from a decline of US hegemony. Certainly, Nixon's actions coincided with underlying changes in global power relations, including the growing economic power and assertiveness of Western Europe and Japan, the emergence of a trade deficit on the US current account as the US share of world exports declined, the achievement of rough nuclear parity by the USSR and the catastrophic defeat of the United States in Vietnam. In addition, THIRD WORLD countries (as well as TRADE UNIONS in advanced industrial nations) had been empowered by two decades of global economic expansion, at the end of which the demand for both labour and raw materials had begun to exceed supply. The formation of a successful oil cartel in 1974 represented a further challenge to US power and exacerbated inflationary pressures that had their origins in US policy.

The crisis of the Bretton Woods system gave rise to a period of theoretical innovation in the study of international relations (IR), especially in the Anglo-American countries. Whereas the relatively smooth functioning of the international economy in the first two post-war decades had seemed to validate the analytical separation of economics and politics as separate disciplines, by the 1970s scholars became interested in the linkages between political power and international economic stability

and change. In his seminal work, *The World in Depression* (1973), CHARLES KINDLEBERGER argued that a stable, open world economy required a single preponderant power able to provide leadership in the form of a market for distress goods and the provision of monetary stability and capital outflows. Prior to World War I, Great Britain had played this role. During the inter-war period, however, Britain was no longer powerful enough and the United States was unwilling or unable to take its place. ROBERT GILPIN (1975) contended that the decline of US hegemony was ushering in a new cycle of world protection. Scholars propounded a HEGEMONIC STABILITY THEORY and questioned whether stability could be preserved through constructing regimes in the absence of the power of the United States. The most influential statements of this position, which provoked charges of ethnocentrism from theorists like SUSAN STRANGE (1988), were offered by ROBERT KEOHANE (1984) and Paul Kennedy (1987).

Yet even as Keohane and Kennedy were propounding the thesis of declining US hegemony, the argument was becoming less convincing. During the late 1980s a number of factors pointed to a continuation of American hegemony, albeit within the context of new institutional forms, technologies and modes of regulation (see MODE OF REGULATION (MoR)). First, the dramatic liberalization of global finance, trade and services not only confounded predictions of a new cycle of MERCANTILISM, but also appeared to strengthen the position of the United States, which benefited greatly from liberalization and actively promoted it. The decline of British hegemony no longer served as a plausible model for the future of the United States, even if the US suffered from a chronically low domestic savings rate and poor educational performance. Second, by the early 1990s the Japanese and German economies had fallen into serious recession and underlying structural problems. Neither SOCIALISM, SOCIAL DEMOCRACY, nor the Asian model of development seemed a viable contender to US-style CAPITALISM. Third, the collapse of the Soviet Union

eliminated the only serious military contender to US hegemony. Fourth, the development of new technologies not only greatly enhanced US military power, as seen in the Gulf War (and later in Yugoslavia), but also digital technologies seemed to increase the gulf between rich and poor, and to reinforce American 'soft power' (Nau, 1990). Fifth, burdened by crippling indebtedness and a collapse of commodity prices, Third World nations were induced either to conform to the wave of GLOBALIZATION on Western terms or face exclusion from global economic institutions – a fate even worse than dependency. Finally, the power of cultural capital, whether via the internet or Hollywood, greatly expanded America's global presence (albeit not without contradictions).

Hence, by the beginning of the 1990s, US hegemony seemed to have been re-established in each of the structures noted by Susan Strange and gave rise to a mood of 'triumphalism' in the United States (and fatalism abroad), as the global order – characterized by free markets and democracy – championed by the United States was proclaimed to be universal and eternal (Fukuyama, 1992). The resurgence of US hegemony, ironically, precipitated a turning away from theoretical innovation in the study of IPE. Indeed, the separation of economics and politics that had been the hallmark of IR studies during the 1950s and 1960s subtly reappeared. While much European and Third World analysis continued to be preoccupied with US hegemony, in the United States itself theoretical discourse began to turn away from the preoccupation with power and return to 'ECONOMISM' in the form of 'RATIONAL CHOICE' or 'idealism' in the form of 'constructivism'.

By the end of the twentieth century, the key challenge to US hegemony came from the EUROPEAN UNION (EU), whose market and military potential (in raw form) is equal to that of the United States. Other potential challengers (such as China) do not appear able or willing to extend beyond the status of regional power. The EU has sought to enhance its global power through the establishment of the

European Monetary Union (EMU) and COMMON FOREIGN AND SECURITY POLICY (CFSP). Neither of these projects appear, however, to represent a fundamental challenge to the United States. Indeed, the depth of US support for each appears to suggest that these projects represent a revision of the terms of American hegemony rather than an attempt to transcend it. In the coming years, the challenge to US hegemony seems less likely to come as a result of the agency of a rival power or coalition of powers, but rather as a result of the lack of institutions and mechanisms to prevent instability at a time of dramatic globalization.

See also:

hegemonic cycle; hegemonic decline; hegemonic stability

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ALAN CAFRUNY

Helms–Burton Act

The Cuban Liberty and Democratic Solidarity Act, known as the Helms–Burton Act after its principal congressional sponsors, was enacted by the United States government in March 1996. The act was a response to Cuba's shooting down of two civilian US aircraft off the Cuban coast in February 1996. It represents the renewed interest shown by US policymakers in unilateral economic sanctions with broad extra-territorial effects (see *SANCTIONS, ECONOMIC*).

The act requires the President to instruct the Secretary of the Treasury and the Attorney General 'to enforce fully the Cuban Assets Control Regulations' (embargo regulations first promulgated in July 1963 under presidential authority). The act also prohibits persons subject to US jurisdiction from financing any transactions involving property confiscated by Cuba from a US national. Furthermore, it requires the Secretary of State to exclude from the US any alien whom the secretary determines to have confiscated or to have 'trafficked' in confiscated property. This exclusion includes anyone who is a corporate officer, principal or controlling shareholder of an enterprise that has been involved in confiscation or trafficking. It also includes anyone who is the spouse, minor child or agent of an excludable person.

The act also authorizes US nationals whose

property was confiscated by Cuba to file suit against any person 'trafficking' in confiscated property. For example, a third-country national who purchased, or financed the purchase of, the crop of a confiscated Cuban plantation formerly owned by a US enterprise (or by a Cuban who is now a US national) could be subject to suit in US court for 'trafficking' in confiscated property. Liability could equal the current fair-market value of the property (plus reasonable costs and attorneys' fees). Liability may equal treble damages and costs and fees, if the defendant had prior notice of the US national's claim to the confiscated property. Acting under authority granted by the act, the President has successively postponed the effectiveness of these provisions every six months.

The act has triggered vigorous criticism. It provoked a legal challenge by the EUROPEAN UNION (EU) before the WORLD TRADE ORGANIZATION (WTO), and trading partners (most notably Mexico and Canada) have enacted legislation countering its effects. The act has also been criticized as a secondary boycott device, targeting third-country nationals that trade with Cuba, with broad extra-territorial implications.

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MICHAEL P. MALLOY

herd behaviour

Herd behaviour refers to a situation in which market participants adopt decisions of others rather than make efforts to come to their own conclusions. There are two approaches to explain herd behaviour. The irrational view describes herding as a phenomenon in which market participants mimic each other's actions without considering relevant information. The theory of rational herd behaviour distinguishes between general and individual rationality. Following the market and ignoring important information can be rational for individuals, although it is inefficient from a social perspective. That is the case when market participants assume that others' decisions reflect better information than they have or when they fear the consequences of disagreeing with the majority.

GABRIELE MEINERT

heuristic models

Heuristic (from the Greek *heuriskein*, meaning 'to find, to discover') signifies finding a solution by trial and error, that is, by using experience. Heuristics is a major problem-solving strategy, used often in computer programs. In antithesis with the algorithms strategy, which is a step-by-step procedure, heuristics is an experimental, especially trial-and-error, time-saving device, utilizing feedback to improve performance. Since the step-by-step procedure leads to numerous alternatives (like the possible number of moves in a

chess game) and is generally impractical, the use of heuristics is inevitable.

Heuristics models are based on actual human behaviour. Richard Petty and John Cacioppo (1988) constructed an 'elaboration likelihood model' (ELM) of the persuasion process, under which there are two routes to attitude formation and attitude change that depend on the elaboration occurring during processing: the central and the peripheral route.

Under the central route (high elaboration), the attitudes are formed and revised after rational and serious deliberation, in those cases where an individual believes that the outcome of this process is of great importance for them. Reasoned opinions formed after such a process are firmly held and changes of opinion are rare. The peripheral route (low elaboration) is used when there is scarcity of time and lack of motivation and/or ability. Since individuals do not have infinite time to follow the central route for all their decisions, in most instances they use heuristics (that is, short cuts, cues, associations, rules of thumb) in their decision-making processes. The peripheral route rarely results in strongly formed attitudes and change of beliefs is far easier.

The difference between the two routes is analogous to the difference between the strong form of hyper-RATIONALITY and the semi-strong bounded rationality. In the first route, decision-making is a cognitive process of ranking alternatives in a rational manner; in the second 'heuristic' route, decision-making is an almost automatic response based on experience. For some theorists (including Petty and Cacioppo), the two routes of information-processing are mutually exclusive; for some others (like Shelly Chaiken, 1980), they are parallel.

The heuristics models (or devices) used by social scientists are based most often on actual empirical research and not on theoretical constructs, and may be applied to the study of social and economic phenomena. These models are essentially working hypotheses that attempt to produce theory by eliminating suggested possible explanations. They do this

by filtering and excluding information (thus limiting the information overload and the marginal costs of transmitting information), and consequently by narrowing down the available choices. In this sense, they constitute guiding principles for manipulating information in order to solve a problem or to form a judgement. The close interrelationship of heuristic models with real-world situations differentiates them from 'grand theorizing' and renders them more user-friendly and time-saving, but also ephemeral.

Sometimes, these models may be conflicting, as in the case of the various managerial models of the firm. Some other times, a heuristic device such as John Rawls' 'veil of ignorance' could be highly successful. In addition, a great number of customs, institutions and social norms could be better examined and explained with the use of heuristic models.

On the negative side, heuristics can sustain stereotypes and can be misleading, as shown by several experiments. A characteristic example is the problem of statistical discrimination, when a stereotype is used for reasons of expediency: for example, in hiring decisions (thereby solving the problem of non-verifiable information). Social cognitive theory has already called attention to the dangers of powerful influence-techniques that are likely to elicit heuristic responses from the individuals who are subjected to them and are used by the 'compliance professions' (sales people, lobbyists, advertisers, politicians, lawyers and so on).

See also:

neo-classical economics; paradox(es) of rationality

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ARISTIDES N. HATZIS

HIDDEN HAND, PRINCIPLE OF *see*
invisible hand

highly indebted poor countries (HIPC) initiative

The highly indebted poor countries (HIPC) initiative is a scheme agreed by the WORLD BANK and the INTERNATIONAL MONETARY FUND (IMF) in 1996 to reduce the external debt of selected developing countries to levels consistent with their ability to pay. The agreement provides a unified framework for debt relief in the sense that it involves all creditors, including the multilateral agencies. A key feature is the use of sustainability thresholds as criteria for eligibility for debt relief, including a ratio of debt service to exports of no more than 20-25 per cent. As of mid-1998, six countries had qualified as potential recipients of HIPC debt relief. These are Bolivia,

Burkina Faso, Côte d'Ivoire, Guyana, Mozambique and Uganda. Uganda has been the first major beneficiary. The programme has been criticized for the heavy CONDITIONALITY under which relief is given; recipients must have completed six years of IMF adjustment programmes. It has also been criticized for its lack of human development indicators of debt service sustainability – for example to indicate the diversion of expenditure to debt service which might have financed health or education programmes.

See also:

debt crisis; less-developed country (LDC) debt management

Further reading

Oxfam (1998) 'Making debt relief work: A test of political will', <http://www.caa.org.au/oxfam/advocacy/hipcapr98.html>. Contains useful information on the HIPC initiative and various suggestions for its improvement.

JOHN THOBURN

Hilferding, Rudolf (1877–1941)

Rudolf Hilferding was a prominent Marxist theoretician and socialist politician in Austria and Germany. With *Finance Capital* (1981 [1910]), Hilferding changed the dominant theoretical paradigm in Marxist economic theory, as he introduced the idea of *stages* of CAPITALISM and the notion of *monopoly capitalism*. Hilferding's approach constitutes the starting point of a new tradition in MARXIAN ECONOMICS which modified MARX's original approach.

Hilferding studied medicine at the University of Vienna and obtained his doctorate in 1901. However, he practised medicine only until 1906 (and during his military service in World War I), as he thereafter devoted himself exclusively to politics and the study of economic theory.

Since the age of fifteen, he had been a member of the socialist movement. From 1902, he contributed frequently to *Die Neue Zeit*, the theoretical journal of the Social Democratic Party of Germany (SPD). In the time period 1904–23, he published in Vienna (along with Max Adler) the *Marx Studien*, as a means of expression for Austrian Marxism.

The first important monograph of Hilferding was published in the first issue of this journal, under the title 'Böhm-Bawerk's criticism of Marx'. It was a rejoinder to Böhm-Bawerk's paper (originally published in 1896) 'Karl Marx and the close of his system'. According to Paul Sweezy (Hilferding, 1949: xix), Hilferding's analysis 'is probably the clearest statement we have of the fundamental difference in outlook between Marxian economics and modern orthodox economics'. Hilferding bases his arguments on the thesis that modern economics fails to comprehend the objective social interconnections which lie behind the apparently subjective relation between individuals and their needs (or the 'goods' aimed to satisfy these needs). In this context, the relationship between supply and demand shall not be regarded as the governing force of capitalist economy. It comes into question only if 'that price of production [brought about independently of this relationship] may be attained which shall yield the capitalist ... the profit for the share of which he has undertaken the production' (Hilferding, 1949: 194).

In 1906, he accepted an invitation by August Bebel, a leading figure of the SPD, and tutored at the party school in Berlin for about a year. Immediately afterwards, he was appointed to foreign editor of the party's newspaper, *Vorwärts*.

After the publication of his major work, *Finance Capital*, in 1910, Hilferding was praised as one of the most pre-eminent Marxist theoreticians since Marx's death, his book being hailed by German and Austrian Social Democratic leaders, like Karl Kautsky and Otto Bauer, as a continuation of Marx's *Capital*. As a recognized Marxist theoretician, Hilferding was appointed (in 1910–11) as a member of the German-Austrian scientific

committee that formulated the editorial principles for the publication of the *Collected Works* of Marx and Engels.

In *Finance Capital*, Hilferding (building upon the basic ideas of HOBSON's *Imperialism* from 1902) introduces the notion of a 'latest phase' of capitalism, which is characterized by the following features: the formation of monopolistic enterprises (which put aside capitalist competition); the fusion of bank and industrial capital (leading thus to the formation of FINANCE CAPITAL, which is considered to be the ultimate form of capital); the subordination of the state to monopolies and finance capital, and, finally, the formation of an expansionist policy of colonial annexations and war.

Finance capital signifies the unification of capital. The previously separate spheres of industrial, commercial and bank capital are brought under the common direction of high finance, in which the masters of industry and of the banks are united in a close personal association. The basis of this association is the elimination of free competition among individual capitalists by the large monopolistic combines. This naturally involves at the same time a change in the relation of the capitalist class to state power.

(Hilferding 1981 [1910]: 301)

The policy of finance capital has three objectives: (1) to establish the largest possible territory; (2) to close this territory to foreign competition by a wall of protective tariffs and, consequently, (3) to reserve it as an area of exploitation for the national monopolistic combinations (ibid.: 326).

Hilferding's analysis considers also *capital export* to be an inherent characteristic of capitalism in its 'latest', monopolistic, stage, emanating from the 'cartelisation and trustification' of the economy and from the need 'to annex neutral foreign markets ... above all overseas colonial territories' (ibid.: 326, 328). More specifically, he comprehends capital export on the basis of a two-fold approach:

1 The *surplus of capital* approach, which

claims that in industrial countries 'while the volume of capital intended for accumulation increases rapidly, investment opportunities contract. This contradiction demands a solution, which it finds in the export of capital' (in developing regions, at least; ibid.: 234).

2 The *colonial extra profits* approach, which claims that colonial or low-wage countries become 'a source of extra profits by ... reducing the cost price of industrial products' and that, therefore, these territories 'can have great importance for the most powerful capitalist groups' (ibid.: 328).

The idea of a 'latest', monopolistic-imperialist stage of capitalism, possessing the above features, was adopted by BUKHARIN, LENIN, KAUTSKY and others, thus shaping the so-called 'Marxist theories of imperialism and monopoly capitalism' that dominated, until recently, most Marxist streams of thought, especially Soviet Marxism.

Hilferding believed that a possible consequence of monopoly capitalism could be the transition to socialism in terms of a simple handover of the state apparatus from the financial oligarchy to the popular majority:

Finance capital puts control over social production increasingly into the hands of a small number of large capitalist associations ... and socialises production to the extent that this is possible under capitalism ... [This] facilitates enormously the task of overcoming capitalism ... it is enough for society, through its conscious executive organ – the state conquered by the working class – to seize finance capital in order to gain control ... of production.

(ibid.: 367)

Although the theoretical paradigm introduced by Hilferding's analysis dominated Marxist theories for nearly eight decades, it may be argued that nearly all its postulates (which Hilferding regarded as indispensable features of the 'latest phase' of capitalism) have been refuted by economic and historical development:

- 1 The domination of bank over industrial capital does not reflect the reality of post-war multinational corporations.
- 2 The era of expansionism, it might be argued, ended with World War II. The same is true of protectionism.
- 3 Given that, in the present time, industrial countries account for more than 95 per cent of world-wide foreign direct investment (FDI) outflows and also for *approximately 80 per cent of FDI inflows*, Hilferding's theses on capital exports may also have been rebutted.
- 4 The idea that capitalist development implies an element of state planning which facilitates transition to socialism (an idea which Hilferding fiercely defended in his articles on 'organized capitalism' after World War I) has also yet to materialize.
- 5 Finally, the very analysis of monopoly predominance over the whole capitalist economy may be disputed on the basis of considerations derived from Marxian theory. This was done (for example) by Lenin, in a rather self-critical manner, several years after he had himself adopted Hilferding's approach: 'The essential feature of imperialism ... is not monopolies pure and simple, but monopolies in conjunction with exchange, markets, competition, crises. This combination of antagonistic principles ... is the essence of imperialism' (Lenin, 1973: 126).

Finance Capital was Hilferding's last book, as he fully devoted himself to politics soon after its publication. In 1914 he voted against war credits and by doing so he joined the left wing of the SPD which, after the party's split in 1917, formed the Independent Social Democratic Party of Germany (USPD). In 1922, after the majority faction of the USPD had been transformed into the German Communist Party (KPD), Hilferding followed the party's minority faction which returned to the SPD. He edited the party's theoretical journal, *Die Gesellschaft*, and was elected an MP from 1924 to 1933. He served twice as Minister of Finance (in 1923 and 1928–9).

When Hitler came to power in 1933, Hilferding went into exile. In February 1941, while planning his escape to the United States from the French city of Arles, he was handed over to the Gestapo by the Vichy authorities. It is thought that he either committed suicide during his Paris captivity or was tortured to death, probably on 11 February 1941.

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JOHN MILIOS

Hirschman, Albert O. (1915–)

Perhaps more than any other contemporary economist, Albert O. Hirschman has challenged many of the traditional ideas and theories relating to economic development and growth. Mark Blaug has noted that Hirschman is a master of lateral thinking: looking at old problems from a new, unexpected angle. More recently, the title of Luca Meldolesi's book, *Discovering the Possible: The Surprising World of Albert O. Hirschman*, captures the widely acknowledged and appreciated nature of Hirschman's creative genius. Although Albert Hirschman is primarily an economist, curious about problems that affect the process of economic development, his work is also highly prized today by political scientists

and sociologists, by students of international organization and by empiricists at the relative fringes of today's formalistic economics profession.

Meldolesi suggests that Hirschman's work can be divided into two main parts, with a turning point occurring with *Exit, Voice and Loyalty* in 1970. Before that, the focus of Hirschman's always interdisciplinary work was on the dialogue with development economics, using its language with psychological over- and undertones. With *Exit, Voice and Loyalty*, he moved to a broader canvas. He incorporates stronger elements of political science, philosophy, psychology and the history of thought, and his work becomes explicitly related as much to developed as to underdeveloped countries.

Throughout Hirschman's work, especially in this second period, is the struggle to be interdisciplinary with his rejection of single-discipline paradigms. Two core elements of his analysis link economics and politics in his post-1970 writing. The first is exit and voice, the tensions between them and their consequences for firm behaviour, for the way the market operates and for policy-making. Second is his view of governments as pursuing two vocations: to be both entrepreneurial and reforming, again with tensions between them.

One of the striking aspects of Hirschman's work is the sharp difference in approach towards economic development between Hirschman and other founders of the field in the post-war period and that of more contemporary international economists. Hirschman and many of his contemporaries write in the tradition of Schumpeter, Keynes and Veblen in that they are aware of the social and even artistic character of economies, that is, they see economic development as a continuously dynamic process with no movement towards equilibrium. They were interested in what initiated and drove this process and how it might be accelerated in a particular country with its own culture and institutional framework. To Hirschman, the standard neo-classical model, while providing insights, is

incapable of identifying the subtleties critical to successful development and growth.

Born in 1915 in Berlin, Hirschman was an undergraduate student at the Sorbonne in Paris and then the London School of Economics in the mid-1930s, obtaining his doctorate in 1938 from the University of Trieste. In 1941 he went to the United States on a Rockefeller Foundation Fellowship. After wartime service in the American army he joined the Federal Service Board in Washington in 1946 as Chief of the Western European Section and published his first book, *National Power and the Structure of Foreign Trade* (1945). In 1952 he went to Latin America as financial adviser to the National Planning Board in Bogota. After two years, he left the Board but stayed in Colombia as a private economic consultant. In 1956 he took his first academic appointment as research professor at Yale University (1956–8) followed by a professorship in international economics at Columbia University (1958–64), a professorship in political economy at Harvard University (1964–74) and finally a professorship in economics at the Institute for Advanced Study, Princeton University, in 1974.

Clearly, Hirschman's experiences have influenced his writings. His days in France in the 1930s taught him to suspect both standard practical orthodoxy and populist simplicities. Hitler and Mussolini warned Hirschman about planning. Even during the slack 1930s, he could observe the power of the price system and the dangers of thoughtless interventionism. Marshall Plan experiences reinforced his doubts about planning exercises, while his consulting work in Colombia and other parts of Latin America and Africa brought home the complexity of the development process.

From these origins Hirschman went on to search for 'hidden rationalities'. This crucial methodological decision put him in the vanguard of mainstream economics. Young economists today, schooled in choice-theoretic models with uncertainty, imperfect information and missing markets, are likely to find Hirschman not so much a heterodox rebel, but rather a forerunner and a rich source of ideas and testable hypotheses.

Throughout Hirschman's scholarly contributions, especially those focused on problems of economic development, there is a continual stress upon learning from experience while preparing and carrying out a project or policy, and on using that learning to improve the results of the effort in order to raise the probability of success for the project itself and for its possible and often unexpected by-products. Success is measured not in terms of just a single project, but also by that project's stimulus to a continuous series of backward and forward linkages in a sustained development process. The state's role is viewed not in an ideological fashion, but in a pragmatic manner depending on the need in the particular situation.

His first book written in Berkeley completed work begun at Trieste on Nazi Germany's trade policy with southern and eastern Europe. Hirschman's main point was that contrary to the classical theorists, the asymmetry in the political power of trading nations invariably influences the pattern of the actual trade that ensues. *National Power and the Structure of Foreign Trade* challenged the premise of classical economics that trade is or necessarily ought to be apolitical.

In perhaps his most influential work, *The Strategy of Economic Development* (1958), Hirschman rejected the then fashionable view that Third World countries must develop by carefully managed process of balanced growth, insisting instead that economic growth is typically unbalanced and that development planning is only effective when it concentrates its efforts on key industries with ample backward and forward linkages to other industries. In a much quoted observation, Hirschman noted that the sociology of successful economic development truly involves 'calling forth and enlisting for development purposes resources that are scattered, hidden, or badly utilized' (1958: 36).

A backward linkage refers to the inputs which an industry employs that connect it with the producers of raw materials, machinery and semi-finished goods; a forward linkage refers to the output which an industry sells to other

industries rather than to final consumers. Hirschman's point was that certain investments will create new investment opportunities and so provide a stimulus to further economic development. In fact assuming they do not have too low a rate of return compared to other alternatives, the best investments may not be those that restore balance within the economy but rather lead it away from equilibrium. Or as Hirschman states it:

In general, development policy ... must keep *alive* rather than eliminate the disequilibria of which profits and losses are symptoms in a competitive economy. If the economy is to be kept moving ahead, the task of development policy is to maintain tensions, disproportion and disequilibria. That nightmare of equilibrium economics, the endlessly spinning cobweb, is the kind of mechanism we must assiduously look for as an invaluable help in the development process.

(ibid.: 66)

However, new investments appropriate external economies as well as creating them and, in certain unfortunate instances, investment may exploit economies while creating diseconomies. The building of a breakwater may lead to the establishment of a fish cannery that smells so bad that incipient office and residential construction in the area never occurs. The opposite possibility to this convergent series of investments that finally comes to a full stop are divergent series in which each investment creates more economies than are appropriated and the stimulus to additional investment becomes ever stronger. In practice, such divergent series may of course be hard to find. The contribution of theory is telling developers what to seek.

Hirschman calls those investments that are net beneficiaries of external economies – namely, those that appropriate more economies than they create – induced investments. By the same token, those investments that are links in a diverging chain of investments, he might term inducing investments, because they create more

economies than they appropriate. From the viewpoint of the economy, induced investments may then be less valuable than they appear to be to private investors, whereas inducing investment may have a greater social than private net marginal product. As Hirschman summarizes his strategy of development:

An ideal situation obtains when ... one disequilibrium calls for a development move which in turn leads to a similar disequilibrium and so on *ad infinitum*. If such a chain of unbalanced growth sequences could be set up, the economic policy-makers could just watch the proceedings from the sidelines.

(1958: 71-2)

The arguments of Hirschman's *Strategy of Economic Development* were further illustrated by the development experiences of Latin America, a subject to which he returned in *Journeys Towards Progress: Studies of Economic Policy-Making in Latin America* (1963), *Development Projects Observed* (1967) and *A Bias for Hope: Essays on Development and Latin America* (1971). In *Journeys Toward Progress*, Hirschman stressed manifold and ambiguous ways in which nations 'journeyed' toward their goals. He examined three economic policy problems in detail: Brazil's actions to alleviate the chronic economic backwardness of its drought-ridden and stagnating north-eastern provinces, Colombia's attempts to improve patterns of land use and land tenure, and Chile's experience with recurring inflation. He criticized the overconfident belief that all problems were inherently solvable, as well as the prevalent notion of that period in Latin America that reform could be achieved only by opposite processes of violent revolution or of peaceful change. Hirschman argued that both routes in fact proposed shifts of power and wealth, and that such shifts were equally a question of contriving alliances and of what he called 'reform-mongering', a method of action that used unsuspected and unorthodox opportunities for manoeuvre and advance.

Exit, Voice and Loyalty (1970) provides a framework to analyse both economic and

political forces in development. Markets and competition are mechanisms for exit; loyalty to an organization or monopoly leaves only voice (protest) as the means to effect change. If a public enterprise, such as the Nigerian railways that Hirschman analysed, has competition (road transport), then consumers will exit and relieve the pressure for reform of the enterprise; but if the enterprise is a monopoly, users are more likely to exercise political voice and work towards reform. In some situations, the iconoclast tells economists monopoly can be more dynamic than competition. By contrast, Hirschman's later analysis of the collapse of East Germany showed that the GDR was successful in suppressing protest so long as it could contain (if not eliminate) *exit*, literally, in the form of emigration. But as East Germans increasingly fled through neighbouring countries during the 1980s, those left behind concluded that state authority had weakened and could no longer suppress protest. In this case, exit and voice reinforced each other.

Along these lines, one of the important extensions of Hirschman's exit/voice model was in the area of the efficacy of competitive federalism. The basic logic is straightforward. If the concern is for the protection and maintenance of individual sovereignty against the potential coercion that may be imposed by political or collective action, the size of the political unit, measured by the number of members, becomes a relevant variable, quite apart from the presence or absence of an exit opportunity. And political authority may be deliberately shared between a central government and component units, with effective sovereignty partitioned among levels.

Consider, again, a large economy in which a central government, coincident in size with the economy, is limited to the carrying out of protective or minimal state functions. How should the extensions of political activity beyond these limits be organized? How should the public-goods and welfare-state activities be structurally designed?

Even if citizens are predicted to remain fixed in location and hence within a single jurisdiction, so that exit is not a potentially effective

means of institutional control at all, there remains a strong normative argument to be made for establishing relatively small and co-existing political units, all of which may be geographically contained within the boundaries of the economic interaction and the territorial reach of the central government. If persons are, for any reason, either unable or unwilling to exercise the exit option (actually or potentially) they may be able to exercise voice, defined here as activity that is participatory in determining political choices. And voice is more effective in small than in large political units. One vote is more likely to be decisive in an electorate of 100 than in an electorate of 1,000 or 1,000,000. Also, it is easier for one person or small group to organize a potentially winning political coalition in the localized community than in a large and complex polity.

But voice is more than a vote in some precise mathematical formula for measuring potential influence over political outcomes. Neither the set of alternatives from among which political choices are made, nor the preferences of citizen-voters, are exogenous to the processes of political discussion. And it is self-evident that the influence of any person in a discussion-process varies inversely with the size of the group.

Even if exit is non-existent in reality, what we may label as 'virtual exit' may be important and relevant in the internal discussion-choice process. The mere fact that co-existing units of government exist and can be observed to do things differently, exerts spill-over effects on internal political actions. As a practical example, even though exit was of some importance (especially in Germany), the observations of Western economies, culture and politics by citizens of Central and Eastern Europe were independently critical in effecting the genuine political revolutions that occurred in 1989-91. As an additional conceptual experiment, think about how much less vulnerable the communist regimes would have been if all of Europe had been under communist domination. Or imagine how prospects for the revolution might have fared in a world without television.

Characteristically, in Hirschman's work the

tensions that exist between exit and voice can help us to understand the dynamics of very different systems and can lead to contradictory conclusions. Hirschman's often counter-intuitive systems challenge use and help us to a richer understanding of human endeavour. As Meldolesi (1995) signals in his title, Hirschman opens up many possibilities we might otherwise overlook. But he does not help us to predict events: there are too many possibilities, too many forks in each causal path. Hirschman himself acknowledges this in describing his work on generalized linkages as 'one thing leads or does not lead to another.'

In *Getting Ahead Collectively* (1984), Hirschman extended his political analysis to grass-root dynamics in Latin America. Here, one of his themes was that, as these countries move toward civilian rule and democracy, there is renewed space to release the 'social energy' of various local organizations dedicated to more popular and participatory forms of development. Although Hirschman alluded only briefly to grass-roots indigenous organizations, they are perhaps one of the clearest reflections of this new phenomenon. Moreover, in Latin America these new indigenous organizations bring an added dimension to the grass-roots development equation – the continuing existence of indigenous languages and cultures that go back thousands of years, before the arrival of Europeans. They also serve as the basis for socially mobilizing indigenous people for the twin goals of cultural reaffirmation and rural poverty alleviation.

In summing up Hirschman's contributions, Alejandro (1984) notes that one is tempted to point out similarities between Hirschman and conservative economists associated with the old CHICAGO SCHOOL: suspicion of planning, faith in the rationality (hidden or otherwise) of the peasant and other private agents, scepticism about foreign aid and bureaucratic 'experts' administering it, a delight in shocking counter-intuitive results and an optimism and 'bias for hope' many critics of mainstream economics find so offensive. But there are many important differences. Searching for inducement mechanisms, Hirschman explores beyond the market;

hence government is not viewed as intrinsically stupid and inefficient. Early exposure to Hegel, Marx and other Continental thinkers gave Hirschman not only a taste for standing things on their heads, but also an admirable willingness to trespass outside the market and to pretend that there are no boundaries among the social sciences. Furthermore, aware of the substance of what today would be called moral hazard, asymmetric information and costly supervision effort (as in the classic example of aeroplane maintenance as opposed to road maintenance), Hirschman displayed (in contrast to the old Chicago School) a greater scepticism regarding the efficiency of the invisible hand. As Alejandro points out, Hirschman has been a rebel and a dissenter not so much against the major traditions of mainstream academic economics, but against the simplifications, banalities and limitations of practical orthodoxy and heterodoxy, and against the charlatanism of practitioners impatient with the subtleties of formal analysis.

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ROBERT LOONEY

historical costs

Historical cost is defined as the original cost of the asset, disregarding possible value changes between the time of purchase and the current period. This principle is widely used in accounting; however, economists usually prefer to evaluate assets at current costs (often including the opportunity cost of ownership or use of the asset).

ALFREDO SAAD-FILHO

historical materialism

Historical materialism is a particular interpretation of history derived from the work of KARL MARX. The standard approach to historical materialism – one shared by apologists and detractors alike – is that societies pass through several modes of production (see MODE OF PRODUCTION), until the end goal of COMMUNISM is achieved. At its crudest, this version of historical materialism suggests that societies pass through five stages – primitive

historical materialism

communism, slavery, FEUDALISM, CAPITALISM and COMMUNISM. The driving force of history is the development of the productive forces, which usually refers to the techniques of production. Historically specific RELATIONS OF PRODUCTION emerge on the basis of their functionality to the development of the productive forces, later overthrown once they have become a hinderance to the further development of the latter. Within this framework, an economic base is said to determine a political and ideological SUPERSTRUCTURE, the latter simply reflecting the needs of the former.

This version of historical materialism was clearly outlined by Marx in his preface to *A Contribution to the Critique of Political Economy* (1859):

In the social production which men carry on, they enter into definite relations that are indispensable and independent of their will; these relations of production correspond to a definite stage of development of their material powers of production. The sum total of these relations of production constitutes the economic structure of society – the real foundation on which rise legal and political superstructures and to which correspond definite forms of social consciousness ... At a certain stage of their development, the material forces of production in society come into conflict with the existing relations of production, or – what is but a legal expression of the same thing – with the property relations within which they had been at work before. From forms of development of the forces of production, these relations turn into their fetters. Then comes the period of social revolution.

(McLellan, 1977: 390)

The implication of this thesis is that there is a metaphysical logic to history, in which the productive forces gradually develop on the way to an inevitable communist future. This occurs despite and not because of the actions of human beings. Human beings are thus reduced to being the bearers of inevitable historical processes. Marx's leading twentieth-century

critic, Karl Popper, argued that this view of history contains the seeds of a totalitarian future, as people that fail to recognize these immutable laws can be sacrificed in order to hasten the movement toward the inevitable goal.

There are also important implications for the study of international political economy (IPE). It can easily lead to an apology for COLONIALISM and IMPERIALISM as they are said to promote capitalist development in the colonies and semi-colonies. This is regarded as necessary and even desirable, because capitalism is seen as a necessary stage for all societies, as it promotes the expansion of the productive forces more effectively than pre-capitalist modes of production (see WARREN, BILL). Both Marx and Engels at times took this position in their apologies for COLONIALISM and for the annexation of 'backward' countries. It was also a view that became the orthodoxy in the Marxism of the Second International (1889–1914) and in the Soviet Union after the death of LENIN in 1924.

An alternative approach argues that history is more open-ended and unpredictable than allowed for by this stagist model. It recognizes that Marx's account of the transition from feudalism to capitalism was applicable to circumstances specific to Britain, and so is unlikely to take similar forms in other parts of the world. Marx himself explicitly argued this in his correspondence with Russian Marxists in 1881. In this account then, Marxism attempts to utilize the concepts that help to clarify historical processes, rather than present a unilinear view which occurs despite the actions of human beings. Historical materialism thus deals with historical processes rather than ahistorical models. This account therefore undermines Popper's critique of Marxism.

In this account the productive forces *per se* are not the driving force of history. The development of the forces of production depend on the outcome of contingent – and therefore unpredictable – class struggles. For instance, what is crucial in Marx's account of the rise of capitalism is the explicit linkage between the emergence of the capital labour

relation and the generalization of commodity production. Contrary to many 'orthodox' accounts of historical materialism, Marx's argument appears to be that capitalism's tendency to develop the productive forces is rooted in the development of capitalist relations of production, and not vice versa. In the absence of direct access to the means of production, both capital and labour must buy on the market their reproduction requirements, and so goods must be produced at a competitive rate in order for them to find sufficient buyers. In practice, of course, such a system did not arrive in Britain overnight and neither is the process without its contradictions. Nevertheless, the argument concerning the specificity of capitalism and the linkage of relations of production to the expansion of wealth, remains one of Marx's most telling analyses.

This view also has important implications for understanding IPE. This approach does not assume that colonialism and imperialism automatically promote capitalist development in the Third World and, even if they do, such 'capitalisms' may take very different forms from those that exist in Europe and the United States. It also recognizes that the development of one part of the world may close off similar avenues in other parts of the world. Nation-states do not develop in isolation from each other and, indeed, some may develop partly at the expense of others.

This alternative account therefore emphasizes Marx's argument that 'men make their own history', while continuing to recognize that they do so in the context of certain historically determined structural constraints. Agency is therefore returned to centre stage and so rigid historical stages are abandoned. This does however undermine key concepts such as base and superstructure, for supposedly 'superstructural' factors such as ideology and politics have played key roles in revolutions in the twentieth century. While an abandonment of economism and rigid determinism may be welcome, it remains unclear how even this more open-ended Marxism relates to other factors such as GENDER relations. One possible answer is that Marxism can uncover some of

the inner connections between social phenomena, but it cannot capture all of them. Its claims to comprehend totality are therefore themselves incomplete, uncertain and contingent. In this way a continued but always ambivalent dialogue can be opened up with other traditions such as FEMINISM.

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- Cohen, G. (1978) *Karl Marx's Theory of History: A Defence*, Cambridge: Cambridge University Press. The best defence of the orthodox approach to historical materialism.
- Larrain, J. (1986) *A Reconstruction of Historical Materialism*, London: Allen & Unwin. Short but highly readable account of a non-stagist approach to historical materialism.
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- Popper, K. (1961) *The Poverty of Historicism*, London: Ark. Still the most important critique of Marxism, one that appears to have also influenced supposedly post-modern thinkers such as Foucault. In fact, the critique only applies to unilinear accounts of history and not to the agency-based approach outlined above.
- Sayer, D. (ed.) (1989) *Readings from Karl Marx*, London: Routledge. Excellent introduction

Historical School, German

to extracts from Marx's writings, organized thematically and with an emphasis on sociology. Does a very useful job in undermining the 'orthodox' interpretation of historical materialism.

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RAY KIELY

Historical School, German

The Historical School was formed in Germany in the second half of the nineteenth century, as a reaction against both the Classical School of political economy and MARXIAN ECONOMICS. The school has its roots in German economic Romanticism on the one hand and in FRIEDRICH LIST's ideas on the other. From the former it took a negative position on abstract theoretical analysis; from the latter a method of economic study based on historical research; from both an opposition to the classical views of individualism and the economic LIBERALISM that individualism entailed.

In this framework, the basic positions of the Historical School are: first, the emphasis on the historical method of analysis and therefore the exclusive use of the inductive method in economic research; second, the rejection of any theoretically drawn economic law – the sole laws which can be inferred are 'empirical laws', drawn from historical monographs and statistical investigations; third, the necessity of a merger between economics and all other social sciences.

The deeper reasons for these considerations lie in the social and economic situation of Germany during the nineteenth century. The German Historical School, expressing the needs of the less-developed German industry which suffered under British competition, had to theoretically support protectionism and hence the national peculiarities of Germany, as opposed to the 'cosmopolitanism' of the Classical School (matching the British indus-

trial objectives for trade LIBERALIZATION). As a result, the analysis was focused on the clarification of the historically concrete and the nationally specific. From this point of view, general laws appear to be of little significance (if of any at all); consequently, the abstract method of analysis (abstracting from local or national peculiarities) is regarded to be useless, while historic evolution of social life is conceived as an inseparable whole.

The Historical School is usually distinguished in the 'Older', the 'Younger' and the 'Youngest'. To the Older Historical School belong mainly three writers: Bruno Hildebrand (1812–78), Wilhelm Roscher (1817–94) and Karl Knies (1821–98). However, strictly speaking they did not form a school, as their approach to economic history was neither uniform nor very different from that of other economists.

The leading figure of the Younger Historical School was Gustav von Schmoller (1838–1917); another important writer was Lujo Brentano (1844–81). Schmoller and his followers completely rejected the idea that a scientific economic theory existed already, with the argument that, until then, there had not been enough knowledge of economic history. They further criticized both the classicists' commitment to unlimited free economic competition and Marxist socialism; however, they were in favour of social reforms ('socialists of the chair'). Their effort to approach social life as an inseparable whole introduced moral issues into the economic analysis and led also to psychological considerations.

The views of the Younger Historical School on the method of economic analysis called forth a critique by Carl Menger, one of the major representatives of the AUSTRIAN SCHOOL. As Menger attacked the Historical School, Schmoller rejoined, and the famous 'Battle of Methods' (*Methodenstreit*) followed.

Arthur Spiethoff (1873–1957), Werner Sombart (1863–1941) and MAX WEBER (1864–1920) were the most eminent exponents of the Youngest Historical School, which carried on the work of the Younger School. Despite all their differences from their pre-

decessors and from one another, these writers remained faithful to the fundamental methodological principles formulated by Gustav von Schmoller.

The views of the German Historical School had a limited influence on economic thought outside Germany. The school's most outstanding disciple in Britain was T.E. Cliffe-Leslie (1825–82). There is, though, a large bulk of books and essays written by authors who followed the principles of the Historical School. These works constitute a collection of valuable material in economic history. However, if all abstract notions are rejected and the analysis is restricted to the accumulation of heterogeneous facts, supposedly describing empirical historic 'laws', economics is reduced to a collection of case studies, which disregards causalities in economic process. It ceases, therefore, to be a distinct theoretical discipline of social science.

Further reading

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— (1897) 'The mercantile system and its historical significance', English edn. <http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3113/schmoller/mercant>. Schmoller's views on the protective system as a means for the creation of a strong state and a sound national economy.

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GEORGE E. ECONOMAKIS
JOHN MILIOS

historicism

Historicism is a critical study of the philosophy of history. It explains the causes and occur-

rences of major events in global history from a philosophical viewpoint. The emphasis here is not on narration, but on the civilizational factors that produce such events and that establish *praxis* in our understanding of historical change.

Examples of such works on historicism are those by KANT, Hegel and MARX in the occidental treatment of history. Kant wrote on the concept of a universal history taking into account the moral imperatives that shape history. Hegel similarly associated the rise and decline of civilizations with moral causes and a *praxis* in such civilizational change, but he also limited his notion of the 'historicist' *praxis* to the Germanic world and treated human RATIONALISM as the reductionist premise of historicism. Marx, borrowing from Hegel, linked all explanation of historical change to a dialectical process of antithesis and synthesis between conflicting social events.

Among the Islamic contributors to the field of historicism are Ibn Khaldun and Shah Waliullah. Ibn Khaldun wrote on the cyclical process whereby a population rises at its primitive roots by solidarity followed by pampered decadence. His attention was on the Arab world as it went through its cycle at that time from a primitively integrated society to a society weakened by problems of governance. Shah Waliullah wrote on the processes that cause a primitive agrarian society to grow into advanced stages and then revert back to changing cycles. He, like Kant and Hegel, made the moral factor the basis of civilizational change.

In recent times, attention to the study of historicism has once again surfaced with the heightened questioning of modernism and foundationalism of the sciences. Post-modernity marks a growing discontent within academia of the blind acceptance of traditional ways of scientific thinking and its applications (see POST-MODERNISM). In the natural sciences, it is being reflected by a rejection of foundations as traditionally prescribed by the scientists. In social thought, it is marked by a deconstructive approach to thinking, expressing and applying alternative paradigms of a structural nature to

economy and society. In post-modern literature, the names of Foucault and Derrida are eminent. Here post-modernity is being expressed through stylistic expressions reflecting a satire of incoherence as a mark of structuralist disorder in analytical thinking.

An example of deconstructionism is found in Kurt Hubner's treatment of the 'historistic' sciences. This means the study of science as it has been confirmed through history. Yet, within this historicist school there exists a degree of relativism caused by contending views among the scientists. Although science in the historicist sense of its evolution is claimed to be axiomatic, whereby all extensions can be derived from few axioms, yet a dialectical process is noted within that evolution. Hubner – referring to Descartes on this matter of scientific relativism – says:

Often the occurrence of the new is more readily analogous to the genesis of a completely differently interpreted world, the contents of which are changed so as to be partly more extensively developed and partly more narrowly viewed.

(1983: 107)

Thus the growing rejection of foundationalism and the rise of deconstructive processes are changing the landscape of science towards relativism and against absolutism.

Such a dialectical method in the natural and social sciences has led to the emergence of non-linear processes in preference to the otherwise deterministic and reductionist methods of logical positivism representing the empirical school. Consequently, the probabilistic idea of change in historicist approach to scientific inquiry has become a study relating to subjective probability. Indeed, dwelling on this very point, JOHN MAYNARD KEYNES in his voluminous treatises on probability theory strongly noted that the economic universe, being subjectively probabilistic, defies precise predictions.

In more recent times, historicism in economics has entered centre stage with the growing contributions of institutionalists and the re-

cognition of chaotic behaviour in the economic universe. 'Economic fundamentals', as proposed by a foundational schema of general economic equilibrium relationships, are being rendered unattainable or costly to attain. A good work in this respect is by Heilbroner and Milberg (1995), in which they point out the problem of the inability of economic theory to explain social phenomena due to its entrenchment of the individual as the unit of analysis. Consequently, many of the so-called non-economic factors of economic theory cannot be studied by the 'marginalist' doctrine. The methodology of historicism appears here in relation to the need for a deconstructive and structuralist explanation of political economy, as opposed to the traditional acceptance of economic theory.

The rising popularity of a dialectical process of understanding scientific and social reality in the framework of deconstruction and rejection of foundationalism is a legacy of Karl Popper and Darwin in scientific methodology. Popper's arguments in favour of an open-ended conjectural universe denies universality to axioms. The emergence of the mind is then seen to be perpetually in flux, mired by the revisionism of scientific axioms and thus of their inferences. In recent times, the field of CHAOS THEORY in mathematics is an example that utilizes such DISEQUILIBRIUM approaches in scientific and social investigations.

In all of these trends within the new academia, we find an increasing emphasis on circularly dialectical and non-axiomatic approaches towards explaining both scientific and social realities (Giddens 1983). These reflect the signs of a post-modernist debate in providing historicist explanation of non-foundational processes. Thus historicism itself has become a methodology for explaining transformations within science, society and political economy in the light of the ensuing conflict between absolutism and relativism.

See also:

Marxian economics; Marxism Leninism

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MASUDUL ALAM CHOUDHURY

Hobbes, Thomas (1588–1679)

The fundamental contributions of the English philosopher Thomas Hobbes to the field of POLITICAL ECONOMY lie in his arguments for a powerful interventionist sovereign state and for theoretical analysis to be based on a positivistic methodological individualism (see INDIVIDUALISM, METHODOLOGICAL). Hobbes was persuaded in this by both contemporary events and intellectual trends. Literary secretary to Francis Bacon, Hobbes had become enamoured of the former's new approach to science and, inspired as well by the works of Euclid and Galileo, became convinced that the natural laws guiding human behaviour were not the moral ones of scholastic theology, but principles of motion and influence operating on basic sentiments of self-preservation and self-

aggrandizement. The Hobbesian individual is one shorn of inherent ethical intuitions and propelled almost deterministically by environment and interest towards (save for an all-powerful sovereign) inevitable social conflict. The clash between parliament and king in seventeenth-century England bore witness of this to Hobbes, who saw the beheading of one king in his lifetime and died only a decade before the chaotic ouster of another.

The notion that individuals in a state of nature would be doomed by self-interest to inevitable conflict underlies Hobbes' 1651 masterwork, *Leviathan* (1996). His rejection of the claim that humans are propelled by moral laws to care for or cooperate with each other bespeaks his fundamental POSITIVISM, an attitude manifest in the common assumption made in the field of economics that normative regulation and judgement is naturally extraneous to modelling human behaviour. Similarly manifest has been Hobbes' methodological individualism – evident, for example, in his depiction of the STATE as nothing but a vast machine whose component parts are individuals in various functional roles. As with positivism, this methodological individualism is one of the hallmarks of classical and NEO-CLASSICAL ECONOMICS, and has generally encouraged the exclusion from analysis of cultural, political, institutional and historical factors. Some political theorists have gone so far as to see Hobbes as the author of the idea of the modern capitalist individual, naturally bound by no moral law, having full ownership of themselves and their own resources, and oriented towards others in relationships of exchange enforced by the state.

It was not Hobbes, however, but John Locke who laid the basis for a modern theory of property rights. Where Hobbes saw the right as one arising from the formation of a state and contingent on the sovereign's pleasure, Locke found it in the state of nature and derived the right from individuals 'mixing' their labour with unclaimed natural resources. This right is not ceded to the sovereign with the establishment of a state, Locke wrote, but rather is amplified by increased security and the

possibilities given by a common currency to amass wealth. Locke's theory of property greatly influenced DAVID RICARDO and KARL MARX.

MERCANTILISM, which advocated direct government intervention in the economic sphere in order to promote the state's general interests, most directly embodied the economic implications of Hobbes' philosophy. Mercantilism often took the form of government protection of domestic industries and restrictions on the export of bullion, policies that had been followed in England since Edward III's protection of the domestic wool industry in the mid-fourteenth century. Such strong interventionist policies fit smoothly with Hobbes' understanding of SOVEREIGNTY. As individuals without the rule of a sovereign are prone to mutual conflict and unable to cooperate for mutual benefit, it only follows that economic prosperity depends on the active interference of a judicious government.

The coincidence of mercantilist policies with a philosophic justification for them did not persist for long. Charles II, patron to Hobbes during the latter's final decade, in fact largely abstained from state intervention in the economy. Regulation of foreign trade by the English state likewise continued to decrease and, as the eighteenth century progressed along with the nascent INDUSTRIAL REVOLUTION, mercantilist activity declined further and further. The trend had parallels in philosophy. ADAM SMITH, in particular, argued that humans are naturally actuated by sympathy for one another and possessed of a guiding moral sense, and famously claimed in *The Wealth of Nations* not only that individuals could efficaciously pursue their self-interest, but that in so doing society would benefit as a whole. Smith's argument for the INVISIBLE HAND effectively eclipsed Hobbes' argument for the necessity of sovereign guidance. Nevertheless, Hobbes' conclusions continue to be influential in political economy and other fields. Faced with situations where individuals seem unable to cooperate for mutual benefit, as happens with negative EXTERNALITIES and FREE RIDER PROBLEMS, the need for a Hobbesian-type

sovereign actor is often discussed. Similarly, economic analyses that employ a methodological individualist focus and that eschew normative considerations (as is still standard today) bear witness to the lasting imprint of his work.

Reference and further reading

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- Macpherson, C.B. (1962) *The Political Theory of Possessive Individualism: Hobbes to Locke*, Oxford: Clarendon Press. Influential argument that the economic implications of the theories of Hobbes and Locke have handicapped the development of a democratic society.
- Perlman, M. and McCann, C.R., Jr (1998) *The Pillars of Economic Understanding: Ideas and Tradition*, Ann Arbor, MI: University of Michigan Press. Compelling account of the lasting influence of thinkers such as Hobbes on the historical development of the field of economics.

DANIEL CORDES

Hobsbawm, Eric (1917–)

Born in Austria, but mainly working in the United Kingdom, Eric Hobsbawm has been the leading British socialist historian of the twentieth century, alongside E.P. Thompson and Basil Davidson. Primarily known to professional historians as a founder of 'working class history' in the 1940s and 1950s – see his collections of essays *Labouring Men* (1964) and *Worlds of Labour* (1984) – and as one of the leading writers of the group associated with the journal *Past and Present*, Hobsbawm has subsequently become best known for the 'Age quartet': *The Age of Revolution, 1789–1848* (1962), *The Age of Capital, 1848–1875* (1975),

The Age of Empire, 1875–1914 (1989) and *The Age of Extremes: The Short Twentieth Century, 1914–1991* (1994).

Originally a relatively orthodox Marxist, his work is of great interest for international political economy (IPE) because of his ability to grasp longer-term movements in the evolution of contemporary CAPITALISM that contribute to the growth of historical sociology (as can be seen, for example, in his influence on the writing of Justin Rosenberg), but also for the methodological journeys it makes. The earlier works reflect an engagement with working class history as a changing pattern of material relations. Although never a strict Marxist, Leninist ideas play a lesser role. Through arguments with Thompson and also through engagement with Italian and French thinking (especially Gramscian writing), Hobsbawm became increasingly suspicious of purely materialist history over the course of his career. Although until the 1990s he continued to see history as the history of productive and class relations, his view of them became more sophisticated and more questioning. In *The Age of Extremes*, he makes a more decisive break with orthodox Marxism (but not with the European left). In his later work, including a book and a number of articles on NATIONALISM that reveal a rediscovery of his own central European roots, and also in a book co-edited with Terence Ranger (*The Invention of Tradition*, 1983), he explores the nature of identity and the ways in which social bonds form and dissolve.

Although capable of holding his own in metahistorical debate, Hobsbawm's encyclopedic knowledge of the detailed sources of documentary history, notably in United Kingdom and Central Europe, ensured that he never lost the respect and affection of technically narrow historians. He also wrote on jazz with equal measures of affection and prejudice (in many articles and the 1998 book *Uncommon People*). His own methodological questioning, as much as his influential and widely translated books, put him at the centre of any argument about the future of humane left ideas after the fall of COMMUNISM. Widely feted in Eastern

Europe, he remained one of the few British historians to maintain a dialogue between continental and British academic traditions. Recently he has sought to revive the conception of 'Mitteleuropa' as a way of understanding how Eastern and Western Europe can overcome the obstacles to what he sees as a reintegration of their once closely interconnected social and cultural heritages.

See also:

capitalism; Marxian economics; Marxism–Leninism

Further reading

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JASON P. ABBOTT

Hobson, J(ohn) A(tkinson) (1858–1940)

J.A. Hobson was born in Derby, the second son of a newspaper proprietor and local liberal official, William Hobson. The young Hobson was sent to the local grammar school before obtaining an open scholarship to Lincoln College, Oxford, in 1876. Graduating from Oxford in 1880, Hobson was a schoolteacher in Faversham until 1882 and in Exeter from 1882, until he left for a life of journalism in London in 1887. In Exeter, Hobson met (along with his future wife) A.F. Mummery, a businessman

with whom Hobson co-wrote his first book, *The Physiology of Industry* (1889).

When he first arrived in London, Hobson was a university extension lecturer for Oxford and London Universities. Though he taught two courses at the London School of Economics, his university lecturing was to play a lesser role after his inheritance from his father's estate gave him sufficient income to allow him to concentrate on his books and journalism. The poor reception of the economic heresies of his first book had contributed to his exclusion from academic life. Specifically, his academic career was thwarted by F.Y. Edgeworth (Political Economy Chair at Oxford, 1891-1922, and Editor of the *Economic Journal*, 1891-1926), who considered his views faulty. He was not offered a university position until late in his life, when he turned down an offer from the University of Manchester because of ill health. However he continued to lecture outside academic circles.

Hobson's move to London brought him into contact with a variety of radical intellectuals and groups. He was a member of the London Ethical Society from 1890 to 1895, when he left to join the more reformist South Place Ethical Society. In 1894 he was a founder-member of a meeting club of radical intellectuals and politicians called the Rainbow Circle. For most of the rest of his life, the Rainbow Circle and the South Place Ethical Society provided a congenial atmosphere where he could develop his ideas and have them subjected to sympathetic criticism.

Hobson was essentially a humanistic critic of current economics, rejecting exclusively materialistic definitions of value. JOSEPH SCHUMPETER notes that

he was an educated man – in the sense of having had a classical education – and an emotional radical, a combination that is responsible for much of the English social science literature of that time. In economics he was self taught in a wilful way that made him able to see aspects that trained economists refused to see and unable to see others

that trained economists took for granted. He could never understand why the professionals did not take to his message and, like so many of this type, was by no means averse to the comfortable explanation that his Marshallian opponents were actuated by an inquisitorial propensity to crush dissent, if not by class interest: the possibility that, owing to his inadequate training, many of his propositions, especially his criticisms, might be provably wrong and due to nothing but failure to understand never entered his head, however often it was pointed out to him. Belated recognition came in Keynesian times mainly on account of his doctrine of underconsumption.

(1954: 832)

Imperial and international affairs constituted major influences on the development of Hobson's thought. An early significant turning-point in his career was an invitation in 1899 from the editor of the *Manchester Guardian* to go to South Africa to report for the paper on the turbulent political situation in that country. In South Africa, Hobson became convinced of the mine-owners' conspiracy and manipulation of politics. Returning to England, Hobson published a collection of his reports for the *Manchester Guardian* in book form as *The War in South Africa* (1900) and analysed the phenomenon of imperialism at greater length in *Imperialism: A Study* (1902).

Hobson's main occupation, besides writing books, was journalism. He published much of his work and tested many of his ideas in the various liberal periodicals of his time. The high point of his journalistic career was his contribution to the *Nation* from 1907 to 1923, under the editorship of H.W. Massingham.

Hobson was a political activist until the last decade of his life in the 1930s. Like KEYNES and other liberals, he opposed the Versailles Treaty, especially the economic provisions such as reparation payments. By the 1930s, Hobson was into his seventies and finally began to receive from academics some of the recognition that was long overdue.

Hobson's contributions are many, as he wrote across a wide spectrum of issues. Two of his contributions, however, stand out and are still relevant today. With A.F. Mummery, he developed the theory of UNDERCONSUMPTION (or oversaving) which was given a generous tribute by J.M. KEYNES. His second major contribution was his analysis of capitalism and, in particular, IMPERIALISM. Critics have pointed to the technical inadequacies of his arguments in both areas, but his influence was significant. In fact his *Imperialism: A Study* (1902) was undoubtedly one of the most influential books of the early twentieth century. His theory of imperialism influenced Marxist and neo-Marxist theories of imperialism from LENIN onwards (see MARXISM–LENINISM; NEO-MARXISM). In a period when 'imperialism' was a catchword of politicians for winning popular support, he portrayed imperialism in a more grim fashion, showing it to be devastating both at home and in the colonies, and pursued mainly in the interest of a few wealthy financial capitalists.

Many of Hobson's views on imperialism were formed during his coverage of the Boer War for the *Manchester Guardian*, and in his subsequent book he made his opinion clear that the war could result in no gain either to Britain or the colonists of South Africa, including the British Outlanders of Transvaal. Hobson's point was that the war was not really fought in order to procure a greater market for British wares. In fact the industrial future for South Africa did not look very bright. Neither would it, mainly for climatic reasons he suggested, be an important destination for British immigration in the future. Thus South Africa was not – and would not be – especially important for Britain from an economical point of view. Instead he concluded the war was in fact a cover to gratify the interests of a very small clique of people: Hobson wrote,

The lesson I learned from this experience [the Boer War] was the dominant power of a particularly crude form of capitalism operating in a mixed field. It became evident that while the politicians were hesitant and divided, the capitalists of the Rand were

planning straight for war and were using the British Press of South Africa as their instrument for rousing the war-spirit in England.

(1938: 61)

In *Imperialism: A Study*, Hobson emphasizes that since the 1870s a new aggressive imperialism had emerged which subsequently led to a scramble for new lands and the dividing up of many of the territories inhabited by non-white populations. At its core, it was the outcome of a struggle between several rival nations and it encouraged a calculating 'greedy type of Machiavellianism', while for the public it was dressed up in doctrines of national destiny and imperial missions of civilization. It was completely different from the old 'colonialism', he emphasized. While for Britain before the 1880s this had implied the colonization of mostly unpopulated areas with a view to developing them economically, inaugurate democratic institutions and prepare them for self-governance within an imperial federation, this was no longer the case. Thus the 'new' imperialism was no longer directed towards lands with a predominantly white-settler population, but rather towards areas inhabited by the 'lower races' and without their general approval. He draws the following division between the old and the new imperialism:

this recent imperial expansion stands entirely distinct from the colonization of sparsely populated lands in temperate zones, where white colonists carry with them the modes of government, the industrial and other arts of the civilization of the mother country. The 'occupation' of these new territories was compromised by the presence of a small minority of white men, officials, traders and industrial organizers, exercising political and economic sway over great hordes of population regarded as inferior and as incapable of exercising any considerable right of self government in politics or industry.

(1902: 27)

Here Hobson stressed that Britain as a nation had little to gain from this new imperialism. His point was that as trade does not always follow the flag, the commercial gain of installing a colonial power in such areas dominated by indigenous people had in fact been very light. Hobson documents this with statistics showing that during the last decades of the nineteenth century, trade with the colonies and dependencies had hardly grown at all, while the trade with other industrial nations – ‘who we regard as our industrial enemies’ – had increased considerably. Also, among the dependencies and colonies the new ‘tropical’ colonies were of very little importance with regard to trade. Neither were there any signs of these areas becoming more important in the future.

It followed, Hobson concluded, that the new imperialism was clearly a failure from the business-policy point of view. Instead it had chiefly meant great expense, which the public was forced to reimburse via its tax bills. As in *The War in South Africa*, Hobson insisted that the producers of this policy were a tiny fraction of finance capitalists who by political and military means had been able to pursue their own interests. In other words, as he noted, although the new imperialism had been bad business for the nation, it had been good business for certain classes and certain trades within the nation:

A completely socialist State which kept good books and presented regular balance-sheets of expenditures and assets would soon discard Imperialism; and intelligent laissez-faire democracy which gave duly proportionate weight in its policy to all economic interests alike would do the same. But a state in which certain well-organized business interests are able to outweigh the weak, diffused interest of the community is bound to pursue a policy which accords with the pressure of the former interest.

(1902: 47)

Behind the new imperialism stood a group of rich finance capitalists and, to some lesser extent, certain industrialists who gained from the arms

race unleashed by aggressive imperialism. The fundamental economic rationale for imperialism was thus, according to Hobson, the struggle for profitable opportunities for investment.

Introducing his views on oversaving or underconsumption, Hobson develops a theory of imperialism which bears some resemblance to later Marxian versions (although he had no sympathy for the Marxists and their aims). Here Hobson claimed that capitalism faced an internal and insoluble difficulty, and that it was forced to turn to imperialism, not out of pure lust for conquest, but as a means of ensuring its own economic survival.

As Robert Heilbroner notes (1968: 178), Hobson was one of the first to see the surprising economic consequences of capitalism's unequal distribution of wealth. With capitalist development, a paradoxical situation evolved in which neither rich nor poor could consume enough goods. The poor could not consume enough because their incomes were too small and the rich could not consume enough because their incomes were too big. In other words, said Hobson, in order to clear its own market, an economy must consume everything that it makes: each good must have a buyer. It was Hobson's view that while the poor could not take more than the bare essentials, the rich lacked the physical capacity for that much consumption. The result was that both individuals and corporations were forced to save. They saved not only because most of them wished to anyway, but because they could not very well help themselves – their incomes were simply too large to be consumed.

Clearly the automatic saving of the rich strata of society had to be put to use, otherwise the economy would suffer from the disastrous effects of a steady withdrawal of purchasing power. But the question was how to put the savings to work. The classical answer was to invest them in ever more factories and more production, and thus to ascend to an even higher level of output and productivity. This was the doctrine laid down by ADAM SMITH, DAVID RICARDO and J.S. MILL. Hobson saw things differently. For if the mass of the people were already having trouble buying all the

goods thrown on the market because their incomes were too small, how (he asked) could a sensible capitalist invest in equipment which would throw still more goods into an overcrowded market. What would be gained from investing savings in another shoe factory, for example, when the market was already swamped with more shoes than could be readily absorbed?

Hobson's answer was that the automatic savings of the rich could be invested in one way which would put them to use without the troublesome accompaniment of more production at home. They could be invested overseas. This was the force underlying imperialism. It is, according to Hobson, 'the endeavour of the great controllers of industry to broaden the channel for the flow of their surplus wealth by seeking foreign markets and foreign investments to take off the goods and capital they cannot use at home' (1922: 56).

Imperialism thus becomes the road to war – not a royal road nor a road of adventure or misadventure, but a sordid process in which capitalist nations compete for outlets for their unemployed wealth. As Heilbronner notes, such a theory of violence and struggle found little encouragement in the official world of economists of the day. Hobson, it was said, kept 'muddling economics up with other things' and, since those 'other things' were hardly suggestive of a world organized around the pursuit of pleasure, the official world regarded the theory of imperialism as a display of the sort of bad table-manners one would expect of a man whose economics outraged such common-sense doctrines as the social beneficence of thrift.

In summing up Hobson's work, one can easily argue that his biggest contribution was his theory of underconsumption, since this concept was a critical component of his model of imperialism. As Schumpeter notes, today most writers who see saving as the source of macro-economic problems need to show why having saved, people refuse to invest, thereby creating unemployment. With Hobson,

saving produces alternating prosperities and

depressions precisely because savers do invest promptly and thereby increase the productive powers of the economic engine beyond the possibility of sale at cost-covering prices. This line of reasoning may be labeled Overproduction-through-Saving and is certainly not Keynesian. But Hobson, like Tugan-Baranowsky before him, went on to point out that most saving is done by the relatively rich and he used this fact to arrive at the proposition that the ultimate cause of cyclical disturbance and of the incidence of unemployment is the inequality of incomes. Therefore we shall understand why economists who are interested in nothing but politically relevant results will hail Hobson as a forerunner of Keynes.

(1954: I,130)

Still, despite his contributions and this praise from Schumpeter, Hobson did not spawn a new generation of scholars developing and elaborating his arguments. John Pheby has summed it up well:

I have mixed feelings about his lack of an academic career. On the one hand the discipline of such a life might have focused his thoughts. However, Hobson is who he is by virtue of the fact that he did his own thing unconstrained by the artificial barriers so often imposed by academia.

(1994: ix)

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holism

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ROBERT LOONEY

holism

The concept of holism, as distinct from an individual or partial approach, implies that the understanding of an entity requires that a broad view be taken of it, that it be regarded as a complex whole. This furthermore implies that interactions between the components of the system of interest are strong, such that useful results can only be obtained using an overall approach. A simple example is that the motion of neighbouring heavenly bodies cannot be explained by studying each in isolation, but only by studying both simultaneously and including their mutual interaction. In medicine, holistic therapies involve treatment of the whole person rather than of particular symptoms or individual malfunctioning organs.

In economics, analyses are carried out at a wide variety of levels. Micro-economics is typically individualist, being concerned with the behaviour of the individual or firm in a given environment. Macro-economics is more holistic, both in the sense that it is concerned with larger scale entities (such as industries or nations) and in that analysis often involves a large number of interacting factors (as illustrated by the widespread use of large-scale economy-wide computer models for forecasting and policy analysis). The complexity of modern economics, where policy measures or external shocks on one part of the system may

have repercussions throughout, argues for such a holistic approach.

In the breadth of his analysis, the work of KARL MARX can be considered as highly holistic. Not only was his canvas national and international, but he embraced several disciplines – economics, sociology, politics and even 'science'. A more recent example of holistic interdisciplinary studies are the 'global models' of the 1970s and 1980s, combining economic, environmental and demographic subsectors in an attempt to capture the major risks facing the world system given a continuation of existing trends, and to assess possible policies needed to avoid them. 'Feedback' mechanisms cause a change in one variable to affect others which may, in turn, cause further changes in the first. In some such models, major disasters are foreseen, with a stable future obtained only if very draconian measures (such as zero capital growth) are taken.

These models have been criticized on many levels. One concern is that many of the 'wholes' (such as 'pollution') are rather theoretical concepts with a poor empirical base. Variabilities in the quality of data employed and problems of interpreting results – in particular, determining which assumptions are responsible for particular outcomes – reduce the confidence that can be placed in these and other holistic computer models. Short-term national macro-economic forecasting models contain more robust and better researched relationships, but still have a mixed success-rate, although studies suggest that they generally perform significantly better than a simple extrapolation of past trends of individual variables.

The appropriate level of coverage and detail depends on the particular properties of the system under study, and the objectives of the analysis. While 'individualism' can undoubtedly be useful, many systems with strong interactions demand a holistic approach.

See also:

individualism, methodological

JOHN CLARK

horizontal integration

Horizontal integration refers to the combination (by, for example, merger or price-fixing), for antitrust purposes, of two firms that would otherwise be in competition. For example, a merger between *Coke* and *Pepsi* would constitute horizontal integration. All cases of horizontal integration potentially violate antitrust law, especially in the United States, although there are defences that can prevent a violation from being found. Horizontal integration is of concern to the government because of the potential decline in competition when one firm combines with another in the same product market.

See also:

imperfect competition; integration; joint ventures; market power; monopoly; oligopoly; perfect competition

STEVEN E. ABRAHAM

'hot oil' cases

'Hot oil' is the term used to describe the NATIONALIZATION (expropriation) of Western oil companies' assets in the Middle East from the 1950s to the 1970s, which resulted in several interesting – and highly controversial – arbitration proceedings. They are so-called because of the 'hot' (that is, stolen) nature of the property concerned.

There were numerous cases, including *Petroleum Development (Qatar) Ltd v. Ruler of Qatar* (1951); *Petroleum Development (Trucial Coast) Ltd v. Sheikh of Abu Dhabi* (1951); *Saudi Arabia v. Arabian American Oil Company (Aramco)* (1958); *Sapphire International Petroleum Ltd v. National Iranian Oil Company* (1964); *BP Exploration Company (Libya) Ltd v. the Government of the Libyan Arab Republic* (1973); *Texaco Overseas Petroleum Company and California Asiatic Oil Company v. the Government of the Libyan Arab Republic* (1975); *Libyan American Oil Company (Lianco) v. the*

Government of the Libyan Arab Republic (1977); *Government of the State of Kuwait v. American Independent Oil Company (Aminoil)* (1982).

Each case is quite detailed, but all of them raised some fundamental questions. The first is the status of natural resources in international law. DEVELOPING COUNTRIES – led by the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) cartel – articulated in the UN General Assembly the doctrine of 'Permanent Sovereignty Over Natural Resources' (GA. Res. 1803, XVI, 1961), which declared that states enjoy the 'inalienable right freely to dispose of their natural wealth in accordance with their national interests'. Therefore, while the first of the oil nationalization cases were being arbitrated, developing countries sought to establish the principle that notwithstanding any agreements that had been made for the exploitation of natural resources, no investment or development contract with a foreign company can override the state's sovereign right to the resource property located on its territory. Whether this articulation was necessary (in the sense that it merely repeated customary norms of nationalization) is an open question. However, in the arbitrations, some states argued that their actions were not a 're-taking' of property (a nationalization), since they retained ownership of the resources at all times. Therefore, the customary practice of paying compensation to nationalized companies would not apply. The opinions of the arbitrators were mixed.

The issues became complicated, however, because many of the investment agreements contained clauses in which the states promised not to exercise their customary right under international law to nationalize the oil fields. When they later did, the issue became whether a sovereign state could agree to limit its sovereign rights through an agreement that represented an act of SOVEREIGNTY. Only in *Aminoil* did the arbitrators find that the state could bind itself in an agreement with a foreign investor to refrain from expropriation, notwithstanding the principle of permanent sovereignty and, more importantly, notwithstanding

customary international law. This decision was obviously contentious.

The arbitrations also raised the issue of the legal status of investment agreements between states and aliens, and here there was considerable disagreement among the arbitrators. Indeed, the 'hot oil' cases were among the first to consider in detail the legal status of 'stabilization clauses'. In principle, a state may change its law in such a way that nullifies any existing investment agreement. However, several of the agreements contained 'freezing clauses' or 'grandfather clauses', which mandate that relevant national laws will remain unchanged for the purposes of the agreement, notwithstanding any subsequent general change. More forcefully, some agreements contained 'intangibility clauses' that prevent the state from unilaterally changing the relevant laws without the consent of the alien company. When the states did change their laws, the question turned on whether a state may so bind itself in a contract with a juridical (private) person or only in a treaty with another state – in other words, in an agreement of a public law character. The arbitrators therefore had to determine whether the investment agreements were of a public law character or private law character. Interestingly, the arbitrators in the *Aminoil*, *Texaco* and *Liamco* cases found that the stabilization clause gave the investment agreement a predominantly private law character and therefore the two parties in the contract became equal. The state contracts through its own free will at the level of a private contracting party – that is, it uses its sovereign powers to relinquish sovereign prerogatives. This is contentious indeed, given that the motivation of the state in entering into the agreement is (ostensibly) for the 'public purposes' of development and the creation of wealth for its people, whereas the motivations of the firm are purely for profit. The implications of these findings for international political economy (IPE) would also be that market actors (firms) and states are to be treated equally in law. This is not only contentious: these arbitrators' conclusions are contrary to general opinion that the state can bind itself

only in relations with another state -- that is, in a treaty under public law.

Another issue in the 'hot oil' cases concerned the 'internationalization' of the contracts. Some oil companies sought to protect themselves from changes in the laws of the state by stipulating that the investment agreement would be governed by a law other than the law of the state party. Some formulations stipulated 'general laws recognized by civilized nations'. Interestingly, the arbitrator in the *Texaco* case argued that 'a nationalization cannot prevail over an internationalized contract'. This raised two questions. First, if the term 'general laws' is taken to mean the normal practice of other states, the question becomes whether a state can be bound by a law that is neither public international law nor its own municipal law, but one imputed through a comparative approach. The second question is whether 'general laws', which is the formulation used by the statutes of the International Court of Justice, means public international law. Either way, the conclusion in *Texaco* is quite contentious and not consistent with general opinion. Indeed, the implication is that juridical persons (firms) could enjoy the same contractual rights in relations with states as do other states.

It could be that because the 'hot oil' cases tested most famously various features of state alien contracts and failed to reach consensus, that BILATERAL INVESTMENT TREATIES (BITs) between the home state of the firm and the host state have become the preferred means of offering protection to foreign direct investors.

See also:

foreign direct investment (FDI)

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JARROD WIENER

hub-and-spoke integration

In the hub-and-spoke model of integration, the hub country has separate free trade agreements with all the other (spoke) partner countries. Such arrangement gives the regional hub the advantages of both separate bargaining with each partner and of being the only country with a free access to the markets of all participating spoke countries. Because of the tariff-free access to the markets of all partner countries, the hub country would benefit from locational advantages for FOREIGN DIRECT INVESTMENT (FDI). Such costs and benefits were the reason why, for example, Canada was 'convinced' to join the United States and Mexico in the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) in 1994.

MIROSLAV N. JOVANOVIĆ

humanitarian assistance

The definition of humanitarian assistance is legally ambiguous. While much foreign assistance is arguably 'humanitarian' in its outcomes, humanitarian assistance refers to financial and other assistance to help people suffering from famine and natural disasters, such as earthquakes and floods, and thus has humanitarianism as its primary motivation. Humanitarian assistance may also grow out of war or gross violations of human rights.

The underlying motivation of most foreign aid programmes is to promote the political and security interests of the givers of aid. The clearest exception to this is humanitarian assistance. For example, humanitarian assistance to Ethiopia, Somalia, Sudan and the Kurdish areas of Iraq in the 1980s and 1990s was motivated by the desire to help those

suffering, and not to promote the interests of donors.

Instances of humanitarian assistance have become more common in the last two decades. The practice has become well established and institutionalized since the creation of the United Nations in 1945. United Nations bodies dealing with humanitarian issues include UNICEF, the World Food Programme, the UNITED NATIONS HIGH COMMISSIONER FOR REFUGEES (UNHCR) and the WORLD HEALTH ORGANIZATION (WHO). In 1992, the United Nations established a Department of Humanitarian Affairs to coordinate the efforts of these UN organizations and organizations outside the UN system also working on humanitarian assistance issues.

In December 1988, the United Nations General Assembly adopted a resolution on 'Humanitarian assistance to victims of natural disasters and similar emergencies', in which it states that 'the abandonment of the victims of natural disasters and similar emergency situations without humanitarian assistance constitutes a threat to human life and an offence to human dignity' (preamble to Resolution 43/131). The resolution calls on governments to 'respond speedily and effectively to the needs for emergency humanitarian assistance expressed in particular through the Secretary-General' (Resolution 43/131). Access to victims must be made freely available by neighbouring states and those states are called on by the resolution to help facilitate the movement of humanitarian assistance. Indeed, the resolution says that primary responsibility for providing aid rests with the affected states, although it points out that where they are unable to act the international community should step in. Indeed, that is usually what happens.

Humanitarian assistance is sometimes administered by humanitarian intervention, defined as the delivery by outside actors of emergency aid to protect the rights and meet the needs of local people without the prior approval of the local government. The United Nations tied humanitarian assistance to its central goal of maintaining international peace and security in 1991, when it adopted Resolu-

tion 688. That resolution makes the connection between extreme human rights violations inside a country and the associated threat to peace and security. Subsequently, using this rationale, the United Nations authorized interventions in Somalia, Liberia, Cambodia and Bosnia. This shows that SOVEREIGNTY, formerly the be-all and end-all of states, is not sacrosanct and that humanitarian assistance can be forced on states if the conditions are right.

State governments have special offices and officials dedicated to humanitarian assistance. The Scandinavian countries are especially well known for their efforts in this area. The governments of developed countries generally set aside special funds for humanitarian relief, but it is usually supplemented by private donations that are funnelled through non-governmental relief organizations. The number of NON-GOVERNMENTAL ORGANIZATIONS (NGOs) devoted to humanitarian assistance has burgeoned in recent decades. The best known is the International Committee of the Red Cross and Red Crescent Society (ICRC), with others including OXFAM and Médecins Sans Frontières (Doctors Without Borders).

ARMED FORCES are sometimes used to bring humanitarian assistance to those in need. The most prominent example of this is the use of military airlift capabilities to move relief supplies from donors to recipients. Military forces have been used in more robust ways, however. In 1992, forces sanctioned by the United Nations, but largely coming from the United States, entered Somalia to provide protection to relief workers trying to move humanitarian aid to people suffering from famine and related starvation.

Humanitarian assistance raises fundamental political and ethical questions. While some will see it as simply AID, others may see it as unwanted intervention and interference (for example, aid to southern Sudan, where forces are fighting the Sudanese government, and assistance to refugees fleeing Serbian troops in Kosovo). Governments with the capacity to do so, arguably have a moral obligation to provide humanitarian assistance to the victims of disaster and war. Victims of famine, flood

and gross widespread human-rights abuses, thereby have a right to such assistance. Furthermore, the need for humanitarian assistance grows with each new civil war, because civilians make up over 90 per cent of the casualties in modern war. But aid is applied selectively: Western governments intervened to bring humanitarian assistance to Ethiopia, Somalia and Bosnia (although after long delays in most cases), but they failed to intervene in Rwanda in the mid-1990s and left the work of relief in southern Sudan to NGOs. This is in large measure due to television coverage. Situations where famine and war are broadcast to Western publics get the most attention, while those hidden from the cameras are less likely to get a humanitarian response. However, humanitarian assistance can prolong suffering by sometimes giving governments an excuse to avoid difficult political action.

See also:

armed forces

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PAUL G. HARRIS

Hutton, Will (1950–)

That he has for many years been employed as a journalist for and as the economics editor of *The Guardian* newspaper, and more recently the editor of *The Observer* newspaper, should not disguise the fact that Will Hutton is one of the most important English contributors to the discipline of political economy since Keynes: Hutton's best-seller, *The State We're In* (1995), provided the most lucid and widely debated critique of the social, political and economic legacy of the Thatcher and Major governments.

Hutton's political economy is based on the tenet that 'capitalism is socially produced and politically governed; it does not spontaneously arrive at its best outcomes' (1995: 16–17). Rejection of both the theory and practice of free-market economics and advocacy of the careful nurturing of markets by social and public action have led Hutton to his central economic argument about British economic performance. This is that 'the weakness of the British economy, particularly the level and character of investment, originates in the financial system. The targets for profit are too high and time horizons are too short' (ibid.: xi). This economic argument has been joined to Hutton's central political argument, which is that 'the semi-modern nature of the British state is a fundamental cause of Britain's economic and social problems' (ibid.: xi xii).

Hutton's remedy for British decline is the creation of a **STAKEHOLDER ECONOMY** and society 'in which market flexibilities are integrated into webs of trust and commitment, and where society acknowledges the imperative of sharing risk and income as fairly as possible' (1997: 103). However, such a society could only come about in Britain after a period of

hydropolitics

sustained political, economic, social and constitutional change on a scale similar to or even greater than that undertaken by Thatcherism during the 1980s.

See also:

stakeholder economy

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SIMON LEE

hydropolitics

'Hydropolitics' is the term used to denote the growing importance of access to and use of water supplies within contemporary international politics and international political economy. Continued population growth and economic expansion is placing water supplies under increasing strain in many parts of the world. The Middle East is becoming a particularly sensitive area of hydropolitics, with Turkey, Iraq and Syria in serious dispute over the waters of the Rivers Tigris and Euphrates, and Israel in conflict with Jordan over the waters of the River Jordan.

R.J. BARRY JONES

ideal types

All fields of modern social science, including international political economy (IPE), employ ideal types in the development and evaluation of theory. First identified by MAX WEBER as a heuristic and expository method of special importance to the historical-cultural sciences, ideal types have been variously defined and employed since that initial formulation. Accordingly, there is sharp disagreement about the meaning and use of ideal types, most pronounced between those who follow Weber's lead and the logical empiricists, such as Carl Hempel. However, there is agreement that ideal types are not classificatory concepts that represent and subsume reality. Both Weber and Hempel caution analysts not to confuse them with descriptions of reality; they are not a special form of typological concept. Instead, ideal types are complex constructs, themselves entailing relationships among concepts.

In his formulation, Weber directed attention to issues of IPE. He identified as ideal type constructs 'the handicraft system', 'capitalistic culture' (or capitalism) and the historical shift from the former to the latter, as well as 'the state', 'economic exchange', 'Marxian "laws"', 'imperialism', 'mercantilism' and 'free trade'. Each of these is an ideal type because it

brings together certain relationships and events of historical life into a complex, which is conceived as an internally consistent system. Substantively, this construct in itself is like a *utopia* which has been arrived at by the analytical accentuation of certain elements of reality. (Weber 1968: 90)

These logical ideals function as limiting con-

ceptions, in relation to which concrete realities can be compared in order to understand their social significance and causal processes. Ideal types are indispensable to the scientific analysis of historical-cultural reality. This is because the 'ideas' that constitute ideal types are among the motivations that propel meaningful human action, and because the full complexity of social meanings of experienced reality is unknowable.

Hempel, by contrast, sees ideal types as implicit causal theories that are not yet well formulated. For him, they have an important role in analysis only if they are rigorously and systematically specified as abstract models that can be empirically tested. If well formulated, they cease to have any special status as ideal types, but become indistinguishable from other scientifically useful causal theories. Exemplary, for him, is the ideal type of 'perfectly free competition' in economics. That limiting construct is a vague intuitive notion. It becomes analytically useful only if it is precisely specified as a set of testable relations among theoretical concepts such as 'cost', 'price' and 'utility' – that is, when it is a rigorous empirical theory and no longer an ideal type.

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RAYMOND D. DUVALL

ideologies of political economy

IDEOLOGIES have been defined as 'patterns of symbolically charged beliefs and expressions that present, interpret and evaluate the world in a way designed to shape, mobilize, direct, organize and justify certain modes or courses of action and to anathematize others' (Kavanagh, 1987: 235). In the study of political economy, ideologies have been used to variously define the relationship between politics and economics, the state and market, both within the sphere of the nation-state and beyond. Although many other political ideologies have contributed to our understanding of the relationship between the state and the market, the three principal ideologies of political economy have been LIBERALISM, Marxism (see MARXISM–LENINISM) and REALISM (here understood to include the earlier doctrines of MERCANTILISM and ECONOMIC NATIONALISM). In recent and contemporary international political economy (IPE), liberalism has been the predominant ideology – whether informing the neo-classical 'WASHINGTON CONSENSUS' of key institutions such as the INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK, or the policy prescriptions of the politicians of the New Right.

The first and oldest ideology of political economy is that which has been based on the theory and practice of national political and economic POWER, and which has regarded nation-states as the key actors in political economy. Historically, this ideology has manifested itself in the form of economic nationalism and mercantilism. It has spawned the work of FRIEDRICH LIST, as a counter to the classical political economy of ADAM SMITH, and (more recently) has informed the political economy of the DEVELOPMENTAL STATES of East Asia. However, during the post-war period and especially since the late 1960s, the

increasing interest of international relations (IR) theorists in the politics of international economic relations has meant that this particular ideology of political economy has been most commonly labelled 'realism' – a term conceived by IR theorists.

Frieden and Lake have suggested that the three core assumptions of realism are that:

- 1 nation-states are the dominant actors and therefore the appropriate unit of analysis in IPE;
- 2 nation-states seek to maximize their power because international politics is a ZERO-SUM GAME based on anarchy, which demands that nations possess the power to defend themselves, and
- 3 nation-states are rational actors that are able to choose the best course of action to maximize their power.

(Frieden and Lake, 1996: 31)

Realism is thus based on the idea that:

The preservation of sovereignty by national communities organized into states and the competition this engenders within an international system in the absence of higher political authority are fundamental facts of international politics.

(Underhill, 1994: 25)

Realism asserts both the primacy of politics over economics and the separation of the domestic and international spheres of political economy. The preservation of national sovereignty is held to override all other questions, including those relating to economics, but realists have acknowledged that economic performance is a critical factor in the determination of national power and strategy.

A number of criticisms have been made of realism. First, in assuming the primacy of the political over the economic, realists have often underestimated the political significance (both domestically and internationally) of economic issues, especially those pertaining to the distribution of resources. As Underhill has noted, a further consequence of assuming that the laws and dynamics of politics and economics

are separate has been that realism has ignored not only the extent to which the laws governing economies have been the product of political conflict, but also the degree to which the COLD WAR and other security questions have constituted the international rivalry of different economic orders – that is, CAPITALISM and COMMUNISM, organizing themselves into the rival security blocs of the NORTH ATLANTIC TREATY ORGANIZATION (NATO) and the Warsaw Pact during the post-war years. A third criticism of realism concerns its conception of the STATE as a unified rational actor that is able to make decisions about international politics based on a clear, untroubled definition of the national interest. This conception has overlooked the extent to which states are themselves the realm of political struggle and internal debate, which has often meant that the definition of the national interest has been essentially contested in all but the most desperate of circumstances (*ibid.*: 26).

The most important theoretical contribution that realism as an ideology has contributed to the study of political economy has been HEGEMONIC STABILITY THEORY: the notion that:

an open international economy – that is, one characterized by the free exchange of goods, capital, and services – is most likely to exist when a single dominant or hegemonic power is present to stabilize the system and construct a strong regime.

(Frieden and Lake. 1996: 32)

Underhill has pointed to the way in which the theory of hegemonic stability – first coined by CHARLES KINDLEBERGER in relation to the international monetary system but latterly developed by Kenneth Waltz into a more systemic theory – has drawn on not only realist but also liberal assumptions concerning the relationship between economics and politics. The liberal assumption that all nation-states would benefit from an open international market economy was combined with the realist assumption that such an open market would be subject to FREE RIDER PROBLEMS caused by

opportunistic nation-states. From this combination, new hybrid variants of realism (namely, neo-realism or structural realism) were developed which contended that a liberal market economy would require a hegemon or dominant power prepared to bear the cost of policing the international economic order. However, the neo-realists posited that the experience of the two previous eras of hegemonic stability – namely, the *PAX BRITANNICA* during the British Empire and the post-war *PAX AMERICANA* of the Bretton Woods international economic order (see BRETTON WOODS SYSTEM) – had been slowly eroded by the relative decline of the respective hegemonic powers in the face of the rise of rival states' economies (Underhill, 1994: 29–30).

As an adaptation of realism, hegemonic stability theory has been criticized on both empirical and theoretical grounds. It has been criticized empirically because the era of Bretton Woods was not a period of open, liberal international markets. On the contrary, Bretton Woods was a system of highly managed liberalism, characterized by a large number of trade barriers (not least those operated by the United States as a hegemonic power), and a FIXED EXCHANGE RATE regime. Hegemonic stability theory has also been attacked on theoretical grounds for, as Underhill has noted, it

says nothing about the *content* of relations among states, and as such fails to explain why a particular state, hegemon or not, might prefer a liberal as opposed to any other order.

(*ibid.*: 31)

The theory assumes that the anarchical nature of the international order determines the political outcomes between nation-states and thereby ignores the fact that IPE is in practice the product of a very complex interaction of political processes that link both domestic and international arenas.

Political economy cannot ignore the need to understand the internal dynamics of both domestic politics and international society. Nor can it overlook the fact that, while states

ideologies of political economy

may have been the most important political actors in the operation and governance of markets, their sovereignty has been increasingly challenged by other actors – not least MULTINATIONAL CORPORATIONS (MNCs) in the private sector and regional, supranational and global institutions in the public sphere: for example, the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), EUROPEAN UNION (EU) and WORLD TRADE ORGANIZATION (WTO). Ultimately, neo-realism shares the same weakness as liberalism as an ideology of political economy, in that it regards the market as a 'natural' rather than political institution – a mechanism with its own economic dynamic for establishing the greatest good for the greatest number. This is to negate the need for political economy to theorize the complex relationship between politics and market, and national and extra-national arenas, through a better understanding of the role of the state (ibid.: 33).

The second major ideology of political economy is liberalism. Liberalism has been the principal ideology underpinning contributions to the study of political economy from West European and North American authors in particular. Liberal political economy is a very broad tradition which emanated from the classical political economy of ADAM SMITH, JOHN STUART MILL and DAVID RICARDO, later encompassed the work of ALFRED MARSHALL and NEO-CLASSICAL ECONOMICS, and more recently has embraced the work of both JOHN MAYNARD KEYNES and those economists (notably FRIEDRICH VON HAYEK and MILTON FRIEDMAN) who have sought to challenge the post-war Keynesian orthodoxy. Indeed, the ideas of KEYNESIAN ECONOMICS and the New Right have been so influential in the conduct of economic policy, at both the national and international levels, as to warrant the status of ideologies of political economy in their own right.

Frieden and Lake have identified three core assumptions in liberal political economy:

1 It is assumed that individuals are the principal actors in political economy and

therefore the appropriate unit of analysis. As a consequence, liberalism seeks to maximize the freedom and WELFARE of individuals.

- 2 It is also assumed that individuals are rational, utility-maximizing actors capable of choosing the course of action that results in the greatest degree of individual satisfaction. Indeed, where given the freedom to operate, individual reason is held to be sufficiently powerful to engender harmony among not only individuals but whole communities and societies, at both the national and international levels.
- 3 It is further assumed that individuals are able to maximize utility by making trade-offs between goods, being prepared to undertake voluntary exchanges of goods and services in the market in order to achieve the most efficient allocation of scarce resources. Liberals therefore believe that because open markets are the most efficient allocators of resources, the role of the state should be limited to the provision of 'PUBLIC GOODS' (that is, those goods and services that increase utility-maximization in society but which will not be provided by the market).

(Frieden and Lake, 1996: 26–8)

Thus, for example, Adam Smith's belief in the INVISIBLE HAND of the free market was tempered by his willingness to acknowledge the legitimate role for the visible hand of the state in the protection of society from 'the violence and invasion of other societies', the provision of 'an exact administration of justice' and 'the duty of erecting and maintaining certain public institutions and certain public works' (Smith, 1925 [1776]: 185). These public institutions and works included the provision of highways, bridges, canals and harbours, the operation of the post office and the general education of the population so to make them more productive workers, and better soldiers and citizens (Viner, 1928: 148).

As Underhill has suggested, where liberalism has been extended beyond the realm of the nation-state, its proponents have advocated the promotion of liberal democracy and open

markets through the agency of international cooperation, institutions and law, and also through social integration and technological development as a means to enhance individual freedom and economic welfare. Liberals believe that individuals have a natural propensity to trade and barter in open markets and therefore that a structure of COMPARATIVE ADVANTAGE and an international division of labour (see DIVISION OF LABOUR, INTERNATIONAL) among producers and consumers will develop provided that the state recognizes that its own limited role is merely to ensure that markets are properly governed so that no artificial barriers to trade arise that might prevent the maximization of human welfare (Underhill, 1994: 27).

Underhill has identified four principal problems with liberalism as an ideology of political economy. First, because liberalism has sought to limit the role of the state and to separate the private sphere of the market from the public sphere of politics, it has tended to deny or ignore the political and institutional context within which markets operate. This is a fundamental weakness because markets are not spontaneous institutions detached from politics. The very essence of the market has been heavily influenced by the interventions of the state, through its laws, regulations and institutions.

A second and related consequence of liberalism's attempt to separate economics from politics, and the state from the market, has been a failure to recognize the importance of socio-cultural institutions and political conflict for determining the nature and outcome of markets. Because markets are neither neutral nor equal in their distribution of resources, the operation of markets has produced major political and social consequences, not least because vested interests in society have recognized the importance of political power in determining who gets what, when and how. A third and further related criticism of liberalism is its tendency for ahistoricism – that is, its insensitivity to the importance of history in determining the character of the institutions of the market and the distribution of income and wealth.

A final criticism of liberalism has been its tendency for reductionism, which has seen the complexity and political dimensions of international economic relations reduced to a simplistic reflection of the international market and the pursuit of utility-maximization within it. As Underhill has concluded, the liberal separation of our understanding of both the state from the market, and the individual from society, has meant that it has been unable to develop a successful theory of politics or the state, when what is required is a political theory of the market that recognizes the role played by politics and the state in the design, construction and governance of the international political economy (*ibid.*: 27–8).

The third principal ideology of political economy is Marxism. While liberalism asserts that the political economy of capitalist society is fundamentally harmonious, Marxism portrays political economy as essentially conflictual. Caporaso and Levine have concluded that the importance of the ideology of Marxism to political economy is that it has provided a radical critique of the neo-classical assumption that society is non-political and indeed should be depoliticized by keeping to a minimum the interventions of the state in the market. From this critique, which asserts the primacy of the economic over the political and challenges the organizing principle of liberal society (namely, the self-regulating market), Marxism has been able to use political economy to develop a radical political agenda based on the idea that capitalism 'inevitably engenders a political challenge to it and a struggle over its most basic institutions' (Caporaso and Levine, 1992: 218–19).

Frieden and Lake have asserted that Marxism makes three essential assumptions:

- 1 Marxists assume that classes are the dominant actors within society and therefore the appropriate unit of analysis. Society is held to be divided between capital, the owners of the means of production and labour – the workers.
- 2 They believe that classes act in their material economic interests.

3 Drawing on the LABOUR THEORY OF VALUE, Marxists assume that capitalist society is based on the EXPLOITATION of labour by capital. The labour theory of value holds that the value of any goods or service is determined by the amount of past and present labour used to create it. Exploitation arises because capitalists are able to expropriate the SURPLUS VALUE (that is, the profits, rent or interest) from the creation of goods and services, thereby denying the workers the full fruits of their labour. As a consequence, the political economy of a capitalist society is necessarily conflictual since the relationship between the capitalist and the working class is fundamentally antagonistic.

(Frieden and Lake, 1996: 29)

As the collapse of COMMUNISM has ultimately and vividly demonstrated, the translation of the principles of Marxism as an ideology into the operation of a centrally planned, command economy has proven extremely problematic (see COMMAND ECONOMIES). Lane and Ersson have contended that two principal problems have arisen in command economies when the state, through its ministry of production, has sought to perform the role of efficient allocator of resources in production and consumption that is played by the invisible hand of the market in a capitalist economy. First, there has been the problem of theoretical possibility: Is it actually feasible in theory for a command economy to allocate resources efficiently? Second, a practical problem has arisen: Is it feasible in practice for the command economy to allocate resources with sufficient efficiency to satisfy the demand of its population? These problems for central planners have stemmed not only from the difficulty encountered in gathering and collating the vast amount of information about producer and consumer behaviour required to allocate resources efficiently – because the state is attempting to replace the market as the determinant of supply and demand – but also, in the absence of market forces, from the need to create incentives for producers to innovate and operate efficiently and for workers to work

in a suitably productive manner (Lane and Ersson, 1993: 113–14).

Underhill has suggested that the principal strength of Marxist political economy, especially when contrasted with the neo-realist perspective, is that it focuses closely on

the connection between the social and economic structures of the capitalist economic system, on the one hand, and the exercise of political power in the international system, on the other.

(Underhill, 1994: 33)

From this perspective, it is asserted that the domestic state is the capitalist state because it institutionalizes the dominance of the capitalist class over the working class. At the same time, as capitalism has become more internationalized, so class dominance has been projected into international politics, where class interests are held to be reflected in the governance of the international economy in the interests of international capital.

The increasing interest of Marxist political economy in the international economy in general and the impact of transnational capital on the political economy of THIRD WORLD development in particular has led to the assertion that the contemporary economic IMPERIALISM of industrialized economies is a much more important determinant of POVERTY, UNDERDEVELOPMENT and dependency than the many internal conditions that have been identified by other perspectives on DEVELOPMENT and modernization. Theorists such as PAUL BARAN and ANDRE GUNDER FRANK have sought to use Marxist ideology to identify the causes of underdevelopment. Baran has attributed underdevelopment to the interest of the propertied and economically dominant classes in the extraction of all forms of surplus value to the detriment of industrialization or the broader development of their societies. Frank has attributed underdevelopment to trade, both international and internal domestic, as the key source of extraction of surplus value (Martinussen, 1995: 88–9). Such contributions, and the more recent insights

provided by the world-systems approach developed by IMMANUEL WALLERSTEIN, are illustrative of the important contribution that theories derived from Marxist ideology have made to our understanding of the political economy of development.

In the post-war period, liberalism has come increasingly to the fore as the dominant ideology of political economy. Initially, this was largely attributable to the important new direction given to liberalism by the work of John Maynard Keynes, who identified a form of MARKET FAILURE far more profound in its implications for the role of the state in the market than that previously furnished by both classical and neo-classical scholars within the liberal tradition. In *The General Theory of Employment, Interest and Money*, Keynes contended that the level of employment in any given economy that resulted from the amount of investment and consumption undertaken would not necessarily equate to full employment. Indeed, full employment was only one of a number of potential outcomes. As a consequence, Keynes advocated the use of the state's MACRO-ECONOMIC POLICIES to ensure that the level of effective demand in the economy would be sufficient to sustain a level of output which would in turn maintain a high level of employment. However, as Keynes acknowledged, 'The central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government' (Keynes, 1936: 379).

Although his political economy was influential in financing the wartime economy, post-war domestic reconstruction (including the social democratic WELFARE STATE and the Bretton Woods international economic order of managed liberalism) owed an even larger debt to Keynes. Indeed, so pervasive was the influence of Keynesian political economy that it could be argued that it should be regarded as an ideology of political economy in its own right. However, it is important to recognize that many of the 'Keynesian' doctrines that formed the basis of economic policy during the Bretton Woods era and were later discredited by the ideology of the New Right, were

interpretations and therefore departures from Keynes' own contribution to liberalism. For example, Keynes had been acutely aware of the risk of INFLATION should the state continue a general expansion of effective demand when unemployment had fallen below 11-12 per cent. At that juncture, Keynes' own prescription had been to abandon further general expansion in favour of specific measures targeted on depressed areas of the economy (Hutchison, 1981: 118). Many post-war governments preferred to ignore Keynes' warnings about inflation and continued to maintain a general expansion of effective demand, because of their desire to manipulate economic performance for short-run political advantage. Thus it can be seen how Keynes' seminal contribution to liberalism as an ideology of political economy was later transformed into the pseudo-doctrine of Keynesianism (see KEYNESIAN ECONOMICS), thereby endorsing Keynes' own stricture that 'Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back' (Keynes, 1936: 383).

Following the partial collapse of the Bretton Woods international economic order in 1971 and the further damage inflicted on world economic growth by the inflation and unemployment arising from the oil crisis of 1973-4, the critique of Keynesian economics and the welfare state that developed in the United States and the United Kingdom during the mid- to late 1970s ironically gave a further boost to the central position of liberalism in the study of political economy. This was because the ideology and policy prescriptions emanating from the New Right were a hybrid of liberalism and conservatism. There was nothing novel about this particular strand of political economy, since many of the ideas emanated from the classical political economy of Adam Smith and were merely 'New' in comparison to the Old Right and by virtue of their incorporation in political manifestos and programmes for government (Bosanquet, 1983: 1).

The ideology of the New Right sought to combine elements of liberalism and conservatism in order to launch an ideological assault

on the post-war political economy of the Keynesian welfare state. It was argued that capitalist societies had a natural tendency to order and growth, wherever entrepreneurs had been given the freedom by open markets to innovate and take risks in pursuit of profits. However, this natural market order and growth had been disrupted and crowded out during the post-war years by the intrusions of state intervention, ownership and control. In theory, the prescription recommended was the restoration of the primacy of individual entrepreneurial initiative as the key agency of social change, through a combination of the liberal free economy and the conservative strong state. In practice, the liberal and conservative strands of New Right ideology appeared to contradict one another when translated into public policy. Liberalism, with its emphasis on limited government, individual freedom and the restoration of a purer form of capitalism, appeared to contradict the primacy accorded by conservatism to the maintenance of societal order, hierarchy and tradition. The result was that the frontiers of the state were redefined rather than rolled back (King, 1987).

Since the collapse of communism, one of the most important contemporary manifestations of liberalism (which has itself threatened to develop into an ideology of political economy in its own right) has been its conception of GLOBALIZATION. Hurrell and Woods have asserted that this conception has been based on three broad assumptions:

- 1 liberal political economy has assumed that globalization of markets will reduce inequality between and within states;
- 2 liberals have assumed that there will be increased demand for international institutions and cooperation because of the growth of political, social and environmental problems associated with expanding markets, and
- 3 liberals have assumed that globalization will tend to promote societal convergence in the long term around the institutions and values of liberal democracy and the market economy.

(Hurrell and Woods, 1995: 448–9)

A number of problems have been identified with this recent global conceptual expression of liberalism. First, there is the tension between the advocacy of a more limited role for the state by the liberal perspective on globalization and the new demands on the state to provide resources and infrastructure to resolve the new social and economic problems arising from globalization. Second, there is the difficulty of reconciling the economic objectives of globalization with liberalism's more longstanding political and social objectives. Third, there is the problem of the inequality between states that arises from globalization. The liberal perspective appears to have overlooked or discounted the growing divide between the affluent, industrialized economies and the impoverished, underdeveloped peripheral economies. Indeed, inequalities appear to have been regarded as a necessary precondition of globalization, in order to provide incentives for capital and production to expand to new areas of the world. However, the cost has been that liberalism has overlooked other dimensions of state power, such as the capacity of stronger states to decide who has access to regional and global markets or the innovations arising from the development of new technology. In short, liberalism has failed to acknowledge that 'the balance between state and market in the process of globalization is itself an expression and reinforcement of political power' and that globalization both affects and is affected by inequalities between states, regions and non-state actors (*ibid.*: 454–5, 458–61).

As the new millennium approaches, some (for example, Giddens, 1998) have sought to move beyond the debate between the old-style SOCIAL DEMOCRACY of the post-war Keynesian welfare state on one hand and, on the other, the neo-liberal agenda of PRIVATIZATION, DEREGULATION and LIBERALIZATION advocated by the New Right, by identifying a 'third way' which (it is claimed) lies beyond the old 'failed' ideologies of left and right. Thus, having witnessed the New Right's attempts to restore an older and purer form of liberal capitalism, the New Left is now seeking to renew social

democracy as both an ideology of political economy and the basis of government policy.

Anthony Giddens, the foremost exponent of the 'third way', has asserted that the five dilemmas confronting society at the end of the century surround (1) globalization and its implications; (2) the extent to which individualism has pervaded society; (3) whether the ideologies of left and right continue to have any meaning; (4) the degree to which politics is gravitating away from orthodox mechanisms of democracy, and (5) how ecological problems should be integrated into social democratic politics (*ibid.*: 27). His response has been to advocate (1) a politics based on a positive attitude towards globalization, but not a blanket endorsement of free trade; (2) the preservation of a core concern with social justice, but nevertheless an abandonment of collectivism; (3) a broadening and deepening of democracy, through a partnership between the state and CIVIL SOCIETY, and (4) a new mixed economy, based on a 'synergy' between public and private sectors. One of the key problems with Giddens' 'third way', both as an ideology and as a programme for government (most notably as implemented by the British Labour government under Tony Blair) is that it excludes large-scale redistribution of income and wealth through the taxation system. As a consequence, the huge redistribution of income and wealth in favour of the rich that occurred under government policies informed by the ideology of the New Right will remain unchallenged at anything more than the margin. While its attractive language of empowerment, inclusion and modernization may prove to be electorally successful in the short term, it is unlikely that in the longer term the 'third way' will succeed in displacing the traditional debates about who gets what, when and how from the state and the market which the more prominent and longer established ideologies of political economy have helped to inform.

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SIMON LEE

ideology

The concept of ideology emerged after the French Revolution and has come to enjoy privileged links with Marxism. Defining it in general terms is a relatively straightforward matter: ideology is a system for making sense of the world, through ideas, images, beliefs and representations. What is more difficult is its analysis, which is approached differently in each discipline and current of thought. This is not attributable to the difficulty of defining ideology, but to the pluralism of thought.

The analysis of ideology bears on the many possible answers to questions such as: what are ideas, beliefs and representations? What is their relation to material reality and to the subject as their vehicle? The answers emerge from combi-

nations of the following elements, potential constituents of a comprehensive definition.

Ideology and truth

Ideology can only be conceptualized in contradistinction to terms such as truth, correctness, science, reason, reality. Whoever speaks of ideology presumes to be in possession of a truth. This 'positivist' starting point has a number of implications.

At one extreme is the enlightenment critique which seeks to emancipate people from ideological delusion. At the other is the view that social action is irrational and ideology imposes 'order', that is, constitutes the most rationalized system for conceptualizing the world.

In between are the organic and total approaches. According to the former, ideology is an illusion which corresponds to a certain reality; it constitutes an 'ambience' which permits individuals to experience their relationship with the world (Althusser, see Eagleton, 1994). According to the latter approach, each 'world-view' (including our own) is situationally determined. Thought and knowledge are related to the social context, a fact which gives rise to manifold distortions. Thus ideology is not a mistake, nor merely a disadvantage suffered by the opponent (Mannheim, 1985).

These views lead to relativism (when no analysis is made of the reasons why a certain conception prevails) or else to an evaluative stance (research into the reasons for a certain ideology). It is interesting that, despite the shared assumption that ideology is the opposite of truth, the term 'ideology' can be utilized in a pejorative, positive or neutral manner.

Some people regard ideology as truth, just as the ideology itself asserts: as a necessary and, in a certain context, obvious truth (Balibar, 1994). Ideology contributes to social reproduction. This is why it is experienced as the 'meaning' of life; it expresses a necessary relationship between subjects and the conditions of their lives. Nevertheless, truth is not merely ideology. A type of critique is possible which gives arguments as to why certain viewpoints are ideologically conditioned, that

is, connected with the exclusion from thought of other viewpoints. This presupposes that it will be demonstrated why a certain truth has been socially constructed.

That is the most fruitful direction for the analysis of ideology and it shows, for example, that the existence of two genders is a social construct which today represents the 'truth' of individual identities, but which nevertheless may be deplored and may change. Because this is an approach which seeks to promote the social construction of a 'better truth', it does not completely transcend the antithesis between ideology and correctness.

Descriptive and normative approach

The term ideology was coined at the end of the eighteenth century by the French revolutionary aristocrat Destutt de Tracy. He sought to describe human ideas in their historical development, considering ideology as part of 'zoology'. At the same time he sought to effect an imposition of correct ideas, eliminating 'metaphysics'.

The descriptive and normative approaches to ideology have up to now been inseparable. In politics, ideology is treated in a purely normative manner. We find fruitful descriptive analysis in social sciences which study the ways particular ideological systems come into existence and the repercussions they have (sociology, aesthetics, linguistics). They try to convey the (ideological) experience of groups and not to denounce prejudices and 'historic mistakes'. Nevertheless, a description of this kind presupposes normative evaluation.

Universality and the end of ideology

Those who link ideology to error and false consciousness believe that it is possible for there to be an end to ideology. This is anticipated as an elitist prospect (a cross-class intelligentsia can rise above the compulsions of bias) or through a change in politico-economic terms.

Some currents of Marxist thought look forward to an end to ideology in COMMUNISM, under which social relations will be 'transpar-

ent', without reality-distorting vested interests. On the other hand, in bourgeois problematics the end of ideology is predicated on the defeat of Marxism, which is seen as an 'ideology' that proclaims CLASS STRUGGLE and sets itself utopian goals of equality and abundance. In both cases, the end of ideology is seen as a concomitant of the victory of a 'world-view' which its opponents perceive as purely ideological. More realistic are theories of the universality of ideology which note that the end of ideology is linked to the utopia of the end of politics, that is, the supplanting of social antagonisms with technical compulsions in production.

Ideology between spirit and matter

Starting from the philosophical contraposition of idealist and materialist tendencies, ideology can be seen as either an idea which directs action or as a reflection of reality. The idealistic viewpoint has three characteristic features: it sees ideas as causal, regards ideology as something positive (an instrument of critique) and postulates individual freedom of action on the basis of their ideals. The materialist viewpoint puts forward the contrary propositions: ideology is a product of the social structure, it favours conservatism and is compulsive in its effects on individuals. Within the materialistic framework, ideology is often seen as something 'spontaneous'. This is what happens with the problematic of COMMODITY FETISHISM as a 'form in appearance' emerging automatically from market exchanges.

It is also possible to see ideology as social practice (production, inculcation and enactment of ideas). Here it is considered that beliefs are produced by professional ideologists who manage 'ideological apparatuses' linked to the state. Ideology thus becomes a question of power relations to be distinguished only quantitatively from COERCION (Althusser, in Eagleton, 1994).

Causal determinations

For idealism, ideas, meanings and beliefs are born in the human mind and those that prevail

are the most convincing. Constructivism describes only which ideas prevail socially at a given moment. For everyone else, ideas are influenced by social context. Marxists, in particular, regard ideology as SUPERSTRUCTURE which is influenced by the material base (forces and relations of production). As for the category of causality, there is great disagreement: absolute determination by the base (ECONOMISM), relative autonomy of ideology, or retroaction at the base? Most Marxists agree in rejecting economism, concurring with other materialist positions.

If we accept that ideology constitutes a social practice, then its relationship with structures of economic production can be more comprehensively specified. Ideology is produced in interaction with those structures: it is a practice which contributes to the formation of a MODE OF PRODUCTION. It is difficult but not impossible for an ideology to find itself in conflict with its 'base' and to prevail while participating in its own downfall. This explains how ideas are determined by material structures and also function as a material force (for example, if in politics the view takes hold that GLOBALIZATION has effaced national sovereignty, that will have social consequences irrespective of the 'real' form of the economy).

The functions of ideology

Materialism holds that ideology increases the cohesiveness of social groups. Many believe that it serves the interests of the dominant groups, distorting and legitimating social relations. For Marxists it contributes to the reproduction of a community founded on EXPLOITATION, securing the hegemony of the rulers through consent to class power.

Disagreement centres on how this hegemony is achieved within CAPITALISM. Some say that ideology imposes the ideas of the ruling class (individualism, nationalism) in conjunction with conservative elements (patriarchy, authoritarianism). Others consider that it expresses ideals of the ruled (freedom, solidarity) which it incorporates into a system of legitimation of the existent.

Only concrete analysis can reveal the functioning of a particular ideological system (for example, naturalizing history or presenting the existent as justified, rationalizing social data or expressing them in an irrational way). In general, ideology simplifies reality, presenting it as a contraposition of good and bad, and tending to efface the historicity of institutions, that is, the vested interests linked to them.

Ideology and individual make-up

Does ideology have to do with the conscious or the unconscious? Does it demand a sociological or psychological interpretation? Ideology poses the question of the identity of the subject, the questions of language and consciousness. The analysis of ideology leads to a theory of determination of the subject by the world and to a theory of relations of conscious to unconscious. Individualistic theories see ideology as false consciousness which is overcome through liberation from illusions. The 'anti-humanitarians' see the subject as an ideological concept which fixes fluid procedures in identities, which correspond to structural elements of capitalism.

See also:

agent-structure relations

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DIMITRI DIMOULIS

IMMIGRATION see migration, international

immiserising growth

Generally economic growth comes from either using more inputs of labour and/or machinery or making better use of the existing inputs. However, a notable exception to this is 'immiserising growth', where economic growth may occur in terms of volume but not value. There are two types of case which have been highlighted.

The first type was identified in the 1950s by Jagdish Bhagwati and arises where the external TERMS OF TRADE move against a country or region as a result of an increased volume of output. For growth to be immiserising, the country's external terms of trade will have to swing against it to such an extent that the deterioration in the terms of trade is large enough to outweigh the physical increase in output so that the country is worse off than before. Clearly for this to arise, the country will have to be a sufficiently large producer of the commodity or commodities for the price fall or falls to affect existing exports.

The second type of case is where the volume of output is increased in industries which are protected by import duties so that although the value of production at one set of (domestic) prices is higher, the value at another (foreign) set is lower than before. Somewhat paradoxically, the volume of output may increase as a result of technical progress in the protected industry and yet the protection may be so great that the increased output is a poor use of the country's resources. This case of improved technical progress in the protected industry

was highlighted by Harry Johnson in the mid-1960s. A similar case involving FOREIGN DIRECT INVESTMENT (FDI) has been highlighted by Richard Brecher (a Canadian economist) and Diaz Alejandro (a Cuban-born economist). In this case, foreign investment may be attracted into industries which are inefficient by global standards but which are profitable because of protection by import tariffs. As a result the country may be worse off following the increased production, in this case partly because of the profits remitted out of the country by foreign investors.

It is worth noting that in the second type of case, immiserising growth occurs as a result of a policy deviation away from free trade, whereas, in the first type, the immiserisation arises in a situation of free trade.

See also:

comparative advantage; fallacy of composition; free trade

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CHRIS EDWARDS

imperfect competition

Imperfect competition results when only a few firms participate in the same market or when consumers perceive particular products as highly differentiated and distinct, so that few substitutes exist. Because only a few companies compete with each other, in imperfectly competitive markets each has some ability to influence the price of its products. By contrast, in perfectly competitive markets, companies have no control over price. Because they are price takers, they cannot depress the price of their product by increasing the amount of a

imperial neglect and underdevelopment

particular good that they put on the market. In imperfectly competitive markets, however, if a company wanted to adopt a strategy designed to increase its market share, it could lower its price in order to attract new buyers.

Economists call markets inhabited by only a few companies 'oligopolies' (see OLIGOPOLY). In oligopolistic markets, one company's strategy will affect the strategies adopted by its rivals. A company competing in an oligopolistic market has to take into account the expected responses of its competitors as well as the responses of consumers to its pricing strategies. The strategic interdependencies among companies in oligopolistic markets create opportunities for these companies to earn profits above the normal rate of return. In contrast, in perfectly competitive markets, by definition companies earn only enough to cover the costs of keeping the owners of a company in business.

One profit-maximizing strategy (see PROFIT MAXIMIZATION) that companies can adopt in imperfectly competitive markets relies on assumptions about the interactive effects among firms' choices of output levels. This strategy, devised by Augustin Cournot in 1838, suggests that a company could increase its profitability if it could convince its rivals to cut back their own output. To accomplish this objective, a company could threaten to increase its output and see if its rivals perceive the threat as sufficiently credible. Unless the rivals perceive the output expansion threat as credible, they will not reduce their output levels.

The economists Jim Brander, Barbara Spencer and Paul Krugman, among others, have developed strategic trade models to analyse the strategic interaction among governments and companies in markets characterized by imperfect competition. These models demonstrate that a government could shift profits from a foreign rival to a domestic company by providing a subsidy to the domestic company (see SUBSIDIES). This subsidy provides the domestic company with the resources to make a credible commitment to expand its production output. Given this, the competitor has no alternative profit-maximizing strategy but to

cut back its own production. This in turn allows the subsidized company to expand its market share and capture some of the excess profits from its foreign rival. Strategic trade models use the assumption of imperfect rather than perfect competition to demonstrate that government intervention in international trade has the potential to be welfare increasing for a domestic economy. Some strategic interventions, however, can result in a net decline in global economic welfare by creating incentives for companies to invest in excess manufacturing capacity.

See also:

oligopolistic competition; overproduction; strategic trade theory

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STEFANIE LENWAY

imperial neglect and underdevelopment

IMPERIALISM is the political and military expansion of countries beyond their borders in order to compete for the control of new markets and inexpensive sources of RAW MATERIALS and labour. Imperial neglect and UNDERDEVELOPMENT refers to the exploitative relationship that existed between imperialist countries and their colonial possessions, and the subsequent lack of significant economic and social DEVELOPMENT in many post-colonial societies. Many of these post-colonial states, located in Africa, Asia and Latin America, are referred to as being underdeveloped due to their low levels of ECONOMIC GROWTH, social services and INFRASTRUCTURE.

From approximately 1850 to 1950, the colonial economies provided raw materials

(such as mineral and agricultural COMMODITIES) to the imperialist countries at low prices that were set by European markets. The economies of the imperialist countries transformed the raw materials into manufactured goods, which were then exported to the colonies at higher prices. This exploitative relationship continued after the colonial states gained political independence, as their economies needed a wide variety of manufactured goods. However, the global price of most mineral and agricultural products remained low. This has made it difficult for many post-colonial states to earn enough FOREIGN EXCHANGE to sustain significant economic growth and development.

See also:

colonialism; dependency theory; development; development of underdevelopment; exploitation; imperialism; least-developed countries (LLDCs); neo-colonialism; periphery; post-colonialism; underdevelopment

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J. ANDREW GRANT

imperial preference

Imperial preference was tariff discrimination in favour of Commonwealth countries. It started in the 1890s and continued until the United Kingdom joined the European Community in 1974. At first, some of the dominions discriminated in favour of the UK. In the following decades, some of the colonies started to give preferences on some items. The UK could not reciprocate until the return to protection, on a few items in 1916 and more generally in 1931. This paved the way towards the bilateral Ottawa agreements of 1932,

between the dominions and the UK (acting also on behalf of any colonies which were not tied by open-door treaties). Most of the 1932 preferences were bound or reduced in the UK-US trade agreement of 1938 and in post-war GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) agreements, which precluded any major new initiatives.

By the 1970s, most of the Commonwealth had outgrown preferences. When preferred production falls short of preferential consumption, the preferred supplier gets a higher price than others. This helps the development of the preferred supplier until preferred production exceeds preferential consumption. Then the surplus has to be sold in world markets at the world price, unless the preferred supplier can organize on monopolistic lines. Post-war domestic legislation in the UK and elsewhere militated against this.

Hence the result was uneven. There were benefits to the producers of butter, cheese and meat (Australia and New Zealand); tea, oil-seeds and rice (India); wood and timber (Canada); to the sugar- and banana-producing colonies (West Indies, Mauritius, Fiji – for sugar, also Australia), and the tobacco and coffee producers (East Africa). Others gained little, if anything. When many Commonwealth economies grew faster than the UK's in the post-war period, most of the benefits ceased, leaving sugar and banana producers to be compensated through special commodity regimes.

FREDERICK V. MEYER

imperial rivalry

Although earlier empires fought against one another on occasion, imperial collapse had more often been a consequence of internal decline or nomadic incursion than of imperial rivalry. By contrast, theorists of IMPERIALISM during the first quarter of the twentieth century regarded rivalry and warfare as characteristic outcomes of imperialism, if not its defining features. Both J.A. HOBSON and JOSEPH

imperialism

SCHUMPETER drew attention to the relationship between international commerce and finance and the state. By very different routes, each reached the conclusion that modern industrializing countries were likely to compete with one another insatiably for foreign markets and investment opportunities, and implicate their parent states in these struggles. Hobson believed that this competition could be soothed by redistributive policies in the home economy; Schumpeter felt that it would fade as CAPITALISM took a more secure hold and political power was prised out of the hands of the European aristocracies. LENIN, by contrast, placed rivalry at the heart of his theory of imperialism, the polemical thrust of which was directed at the suggestion (from KARL KAUTSKY) that the capitalist states might in principle be able to cooperate in a mutually advantageous division and EXPLOITATION of the rest of the world. Lenin argued, by contrast, that limits on the extensive expansion of capitalism had led to an unavoidable conflict, characterized in his own day by the repatriation of imperial rivalry from the colonial fringe into the heart of Europe – hence Lenin's insistence on regarding World War I as an imperialist struggle.

See also:

ultra-imperialism

CHARLES JONES

imperialism

In popular political discussion, the term 'imperialism' has long been used to refer to a wide range of unequal power relations, especially (but not exclusively) those involving the domination of powerful states over weak ones, whether by economic, cultural or coercive means. In addition, theories of imperialism dating from the early twentieth century have had a special and enduring relevance for students of international relations (IR), because they made bold though conflicting claims

about causal links between the economic and political spheres and aspired to offer systemic explanations of war between great powers. These concerns of the classical theorists led them to adopt strongly counter-intuitive definitions of 'imperialism' and a great deal of the fog surrounding the term has resulted from dissonance between the technical definitions proposed by the theorists and standard English usage.

Imperialism as colonialism

The trouble began when Anglo-American liberal historians simply assumed the 'imperialisms' of the social theorists to be close synonyms for 'colonialism' – referring to the acquisition by European powers (and later by the United States and Japan) of formal dominion over non-European territories and peoples. Historians working within this paradigm often contrasted an older imperialism (extending from the late fifteenth-century European discoveries to the American wars of independence) with the 'New Imperialism' of the period after 1870, which saw European powers engaged in the so-called 'scramble for Africa' after a lull in the mid-nineteenth century. Liberal publicists of the time, such as RICHARD COBDEN, had promoted the idea of withdrawal from empire, arguing that colonies were part of the mercantilist baggage that LIBERALISM and FREE TRADE were destined to sweep away (see MERCANTILISM). Some economic nationalists at the time, notably FRIEDRICH LIST, dissented. Far from being its negation, the policies of hegemonic Britain during the *PAX BRITANNICA* could be seen as a specific 'informal' variety of imperialism. This was consistent with the approach adopted much later by Gallagher and Robinson in 'The imperialism of free trade' (1953), which drew attention to a steady growth throughout the century of 'informal empire' in response to events outside Europe. On this view, reluctant resort to more formal control after 1870 was a response to relative economic decline, strategic exposure and the breakdown of cheaper informal means, more symptomatic of the

insecurity of the status quo of the great powers, and of British hegemony in particular, than of any fresh assertiveness.

But although Gallagher and Robinson transformed the periodization of imperialism and extended the scope of historical writing to embrace all aspects of the expansion of Europe, they failed to clarify the discussion of earlier theorists of imperialism, who were still assumed to have been strictly concerned with explaining colonial acquisitions. Moreover, the older definition continued to be widely accepted in North American writings on IR, including the work of realist theoreticians such as ROBERT GILPIN (1981: 23) and Kenneth Waltz (1979: 20–29). Not only did imperialism-as-colonization conform to common usage, it had the additional advantage during the COLD WAR of protecting a self-image of the United States as itself a post-colonial and therefore staunchly anti-imperialist nation, notwithstanding its evident worldwide military and economic power.

Historians and the 'Hobson–Lenin' thesis

Whatever their views on the definition and timing of imperialism, observers have generally agreed that the period after 1890 saw intensification of rivalries between the great powers and a tightening of administrative and economic control over existing colonial empires. It was these systemic aspects of the 'New Imperialism', much more than territorial acquisition *per se*, that provided the common empirical ground for historians to engage those Marxist and radical theoreticians of the early twentieth century who had coincidentally used the term 'imperialism' or its cognates in their attempts to explain the marked deterioration in relations between the major powers from the 1890s to the onset of World War I. J.A. HOBSON, JOSEPH SCHUMPETER and LENIN – the first two liberals, the third an unorthodox Marxist – had all produced distinctive definitions and theories of imperialism before 1918 and by the 1950s their work was widely available in English editions.

Confusing the very different approaches of Hobson and Lenin, David Fieldhouse (1961) demonstrated how the Russian revolutionary had failed to provide a convincing explanation of colonial expansion. By Lenin's own admission, MONOPOLY CAPITALISM – which he identified with imperialism – took hold after 1890, too late to account for European territorial expansion, while surplus capital had gone largely to areas (such as the Americas) that escaped subsequent formal European control. As Kenneth Waltz would later note: 'the cause (capitalism) [was] much younger than the effect ... (imperialism)' (Waltz, 1979: 25).

Lenin

This critique ignored the fact that Lenin's pamphlet, *Imperialism: The Highest Stage of Capitalism* (1973 [1917]; first drafted in 1916), tried to account for the outbreak of war between the leading capitalist states, to counter KARL KAUTSKY by presenting armed struggle between the great powers as an unavoidable consequence of capitalist development, and to explain why parties of the left in the belligerent states had placed loyalty to national capital above transnational class solidarity in 1914. Lenin had not set out to account for European colonization of the tropics. On the contrary, he specified that imperialism commenced only when colonization ended (Lenin, 1973 [1917]: 106). Moreover, the virtually complete territorial division of the world by the great powers was, for Lenin, only one of a number of facets of imperialism. Concurrent anti-competitive division of raw materials and world markets between large corporations (monopoly capitalism) and the control of industrial production by large banks (FINANCE CAPITAL) were not causes but analogues of concurrent territorial division. Only to liberal commentators, convinced that Marxists believed political outcomes to be determined by economic causes, could it appear that Lenin regarded monopoly and finance capitalism as the causes of territorial rivalry. On the contrary, for Lenin economic and political phenomena alike were superstructural epiphenomena,

merely symptomatic of changes in underlying material conditions. The crucial feature of imperialism was that spatially extensive development of the capitalist system was no longer possible, and the great powers and their capitalists alike were therefore caught up in a ZERO-SUM GAME consisting in highly conflictual *re-division* of territory and markets alike in which (as Lenin made clear) it was as much imperialism when France and Germany clashed over Alsace or Lorraine as when the same countries took charge of distant agrarian territories (ibid.: 109).

As Eric Stokes (1969) pointed out, the error of Cold War historians had been to exaggerate the extent to which Lenin relied on Hobson's general argument, rather than merely borrowing details from the earlier study. Only neglect of quite fundamental differences between the two theorists, compounded by uncritical retention by political scientists of a once orthodox historical interpretation, can explain why the opportunity to evaluate Lenin's pioneering attempt to devise a truly systemic IR theory was lost. Lenin produced a theory of war that was fatally flawed by its failure to appreciate the dynamism of CAPITALISM; he did not produce a defective explanation of colonial annexation.

Hobson

While Lenin's pamphlet and related contemporary works by RUDOLF HILFERDING (1910), ROSA LUXEMBURG (1915) and NIKOLAI BUKHARIN (1915) had been only peripherally concerned with the colonial rivalries of the great powers, the two major liberal theorists of imperialism (Hobson and Schumpeter) were more directly interested in this phenomenon, each from his own particular national standpoint. This is especially true of the Englishman, J.A. Hobson, whose *Imperialism: A Study* (1902) was written in reaction to the Boer War (1899–1902) and who therefore came closest of all the classical theorists to identifying imperialism with colonialism. In further contradistinction to Lenin, both Hobson and Schumpeter regarded capitalism as a funda-

mentally pacific influence, each (in a different manner) blaming war between the great powers on the incompleteness or corruption of liberal reform.

Hobson's theory of imperialism was a conflation of innovative economic analysis and weak sociology. Like JOHN MAYNARD KEYNES, who admired him, Hobson attacked the assumption of NEO-CLASSICAL ECONOMICS that markets would always clear. Instead, he contended that under conditions of extreme maldistribution of income of the sort that prevailed in Britain at the end of the nineteenth century, the rich would oversave and the poor would be unable to consume all the goods produced by the national economy. UNDER-CONSUMPTION would lead capitalists to seek investment opportunities and markets overseas. But if several economies were more or less simultaneously obliged to adopt this stratagem, the result must be fierce competition for third-country markets coupled with growing demands for protectionism and annexations. Far from reflecting the national interest, foreign policy would be captured by sectional interests.

Whereas earlier British radicals like Richard Cobden had followed Tom Paine and prefigured the Austrian, Joseph Schumpeter, in regarding aristocracy and the hereditary principle as the foremost causes of war, Hobson looked elsewhere to explain how the economic pressures he had observed were translated into political behaviour. Toying with marginally competitive traders, whose effectiveness as political lobbyists might be doubted, he finally plumped for financiers. 'Does anyone seriously suppose,' he demanded, in a passage that nicely captures the racist undercurrent of Edwardian liberalism, 'that a great war could be undertaken by any European State ... if the house of Rothschild and its connexions set their face against it?' (Hobson, 1902: 57).

Schumpeter

Hobson had maintained that the disruptive effects on IR of competitive DUMPING of capital and goods could be avoided by state intervention in the advanced industrial econo-

mies aimed at achieving a more even distribution of income. Joseph Schumpeter, in much the same way, regarded imperialism as a remediable disorder of capitalism. However, he defined imperialism quite differently from either Lenin or Hobson as 'an objectless disposition on the part of a state to unlimited forcible expansion' (Schumpeter, 1951: 7). The great deficiency of Marxist social analysis, he believed, was the assumption that class relations reflected the current mode of production. If that were so, no rational interest in forcible expansion would remain, since 'capitalism is by nature anti-imperialist' (ibid.: 96). Instead, the once highly functional militaristic inclinations of hereditary monarchs and aristocracies had survived an incomplete bourgeois revolution and lingered into the new era. The consequence was a social atavism that Schumpeter termed 'imperialism'.

Schumpeter comes closer to Hobson, and even to Lenin, when he turns from historical sociology to more detailed analysis of his own times, noting the manner in which the rising bourgeoisie in many European states had been deflected from their rational and pacific mission through corrupting association with older social formations. Like Lenin, his immediate objective was to explain the outbreak of World War I; unlike Lenin, Schumpeter rejected the thesis that this could have been a consequence of capitalism. Instead, the culprit was identified as protectionism. *TARIFFS*, originating in the need for state revenue, allowed large manufacturers in oligopolistic or cartelized sectors (see *CARTELIZATION*; *OLIGOPOLY*) a substantial premium on domestic sales. However, if they increased production to a level that optimized unit costs while maintaining the high domestic price, total revenue would be most easily maximized by dumping the surplus overseas. From this point, the argument followed a course similar to Hobson's, as competitive dumping and foreign investment would lead each national bourgeoisie to demand political and military support from its home government. Schumpeter's targets were the various neo-Marxist arguments circulating in Central Europe, of which Lenin's was

only one. 'Export monopolism does not grow from the inherent laws of capitalism,' he insisted, before concluding that 'it is a basic fallacy to describe imperialism as a necessary phase of capitalism, or even to speak of the development of capitalism into imperialism' (ibid.: 117-18).

Theories of imperialism after decolonization

Schumpeter's eccentric characterization of imperialism as social atavism led, by an entirely logical chain of reasoning, to the conclusion that Britain was scarcely imperialist and that the United States never could be – Britain because the aristocracy had yielded effective political power to the bourgeoisie and the United States because it had no hereditary aristocracy. However, by the 1960s Marxists and liberals alike confronted a world in which aristocratic power was no longer a central issue and where the exigencies of total war had created strong anti-competitive bonds between leading states and their economies and oligopolistic corporate and social structures which, though sociologically distinct from Schumpeter's atavism, were functionally equivalent. Withdrawal of formal European control over vast territories through the process of *DECOLONIZATION* exposed stark, ineradicable and mounting asymmetries of power and wealth between legally sovereign states, which were aggravated by the protectionism of nominally liberal Western economies in a range of sectors, including agriculture and textiles, and by the emergence of powerful *MULTINATIONAL CORPORATIONS* (MNCs) based in the same wealthy economies.

In such circumstances, it is no wonder that 'imperialism' should have come to refer to all and any manifestation of the inequality of states – each with its appropriate prefix: 'neo-', 'economic', 'cultural', 'structural' and so on. *Pace* Schumpeter (and in spite of a lack of strictly territorial ambitions), US policy in South-East Asia during the 1960s was widely held to be imperialist, as were the economic

relations of European powers to their former dependencies.

After 1960, the most creative development of the Marxist theory of imperialism took place through the work of BARAN, Sweezy, Magdoff, Kemp and GALTUNG in Western Europe and the Americas, as well as of the Latin American dependency school. The political objective of the *dependentistas* was to marshal support for armed struggle in Latin America by demonstrating the impossibility of satisfactory economic and social development for late-comers within the capitalist economy and the consequent futility of centre-left coalitions. In short, the call of the *dependentistas* to AUTARKY and guerrilla warfare was the policy prescription of a somewhat unorthodox marriage of nationalism and Leninism, in which the upper hand of the latter was recognizable in an emphasis on the inexorably unjust consequences of capitalism and the consequent unavoidability of armed conflict.

When rapid economic growth took place in several post-colonial countries, contrary to prediction and in spite of the absence of effective and independent national bourgeoisies, some *dependentistas* took refuge in the nationalistic conjecture that the state could achieve relative autonomy from weak or compromised domestic social forces and assume the task of economic development. To a point this happened, with state bureaucracies and multilateral financial organizations providing the vanguard in two successive phases of reformism, the first consistent with Hobson's diagnosis and the second with Schumpeter's.

Between the 1930s and the 1970s, the prevailing response to imperialism defined as asymmetry was to mirror the social and economic structures that seemed to confer advantage on the richest economies by a combination of IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) and WELFARE CAPITALISM of the sort first applied by RAUL PREBISCH and the Latin American structuralists in the sub-continent and later, more widely, through the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) (see also STRUCTURALISM). In so far as it addressed

inequality, both within and between nations, this policy can be seen as a logical response to Hobson's analysis. Its fatal flaw was that it countered one market imperfection with another. By the 1970s, the cumulative consequences of this approach for public finances were hardly sustainable and a second wave, this time of neo-liberal reforms (see NEO-LIBERALISM), began to sweep across the world – sometimes readily adopted (as in Pinochet's Chile or Thatcher's Britain), sometimes more reluctantly (as in India or Brazil) – which promised to put to the test Schumpeter's bold contention that a fully capitalistic economy, once freed from export monopolism by trade liberalization and effective competition policy (see LIBERALIZATION OF TRADE), can offer no ground for imperialistic conflict between states. At the same time, the universalist ethical claims of this resurgent post-Cold War liberalism, and the readiness of its more extreme adherents to advocate intervention in support of Western concepts of democracy, human rights and property, have raised fears of a second 'New Imperialism'.

See also:

Marxism-Leninism

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CHARLES JONES

IMPERIALISM, INTERNAL see colonialism, internal

imperialism, Marxist and post-Marxist interpretations of

The term 'imperialism' has acquired many meanings since it was first used and continues to generate controversy. These changes in emphasis and interpretation are not always made explicit, leading to ambiguities and misunderstandings. A common meaning today, sometimes distinguished from other meanings by the term 'neo-imperialism', refers to the political and economic dominance of major capitalist countries over LESS-DEVELOPED COUNTRIES (LDCs). This, it is argued, leads to the economic EXPLOITATION of LDCs, distorting and hindering their development. Some authors detect cultural and other forms of imperialism in the contemporary world. An early usage of the term 'imperialism' refers to the conquest of territories. During the era of worldwide capitalist expansion in the second half of the nineteenth century, European countries fiercely competed for colonial territories in the 'scramble for Africa' and other parts of the world, mainly Asia. The imperial power secured domination of the colony by military as well as by socio-political means. This occurred when the allegiance of local dominant groups was sought to gain and retain control over the colony in return for some of the spoils of imperialism. The imperial power expected to profit economically by extracting the colony's riches and politically by extending its 'sphere of influence' in international relations. For example, during the colonial era the term 'imperialism' refers to the British Empire (see EMPIRE, BRITISH), while during the COLD WAR era of the SUPERPOWERS it was used to

refer to 'American imperialism' and 'Soviet imperialism'.

Following DECOLONIZATION after World War II, 'imperialism' acquired new meanings. Some theorists argue that the demise of the formal empire did not put an end to imperialism, as the exploitation of former colonies continues through international trade in the form of UNEQUAL EXCHANGE and foreign investment, especially by MULTINATIONAL CORPORATIONS (MNCs) and MONOPOLY CAPITALISM. Hence 'imperialism' has acquired additional connotations, meaning both the world capitalist system as a whole and the economic exploitation by and political dominance of the developed countries (DCs) within it.

Marx on colonialism

The starting point for a Marxist theory of imperialism is KARL MARX's writing on the development of capitalism and COLONIALISM. Marx himself hardly uses the term 'imperialism', speaking instead of 'colonialism'. For Marx, colonialism played an important part in the development of capitalism in Europe and in the creation of a world market. Colonialism contributed to the process of original capital accumulation in Europe as the colonial powers were able to secure cheap raw materials and find new markets for their expanding industry. Colonialism also helped to counteract the fall in the rate of profit, which Marx held to be an inherent tendency of capitalism.

Marx saw colonialism as a progressive force as it destroyed the pre-capitalist modes of production and hastened the transition to capitalism which Marx considered to be a superior MODE OF PRODUCTION. Marx had a progressive view of history and he favoured the expansion of capitalism on a world scale. Thus he was against protectionism and in favour of free trade, as this helps to destroy the old mode of production which kept backward countries stagnant. As Marx wrote, 'the country that is more developed industrially only shows, to the less developed, the image of its own future' (1976 [1867]: 91). However, Marx's view on colonialism changed. Following his analysis of

the Irish Question and his correspondence with Russian populists and Marxists, Marx envisaged the possibility that colonialism can become an obstacle to the development of the colonies. In the case of Ireland, he even favoured protectionism to assist its industrialization. His analysis of India was also revised, as he no longer regarded the destruction of communal land rights by the British as a necessary, if brutal, stage but as 'an act of English vandalism which pushed the indigenous people not forward but backward' (quoted in Larraín, 1989: 49).

Marxist theory of imperialism

A Marxist theory of imperialism emerged at the beginning of this century to account for the rise and increasing power of monopoly capitalism. This led to economic and political rivalry between advanced capitalist countries, expressed in conflicts over territory and, ultimately, to inter-imperialist war. While RUDOLF HILFERDING, ROSA LUXEMBURG and NIKOLAI BUKHARIN can be considered to have made the main contribution to the Marxist theory of imperialism, LENIN was its main popularizer. These authors give different explanations of imperialism's purpose: for Luxemburg it was the problem under capitalism of UNDERCONSUMPTION, which created the need to find markets in the non-capitalist areas of the world; for Hilferding and Bukharin it was the need to counteract the rate of profit's tendency to fall.

Luxemburg, writing before World War I, argued that capitalism in the advanced industrial countries faced a problem of capital realization, meaning that it could not find markets for all the commodities it produced. Markets were initially found within the non-capitalist sector of the advanced capitalist country, but as these gradually disappeared, they were later found in the non-capitalist areas of the world, largely located in the LDCs. The advanced capitalist countries also needed to trade with the LDCs in order to obtain access to cheap raw materials and labour power. Thus, capital accumulation in Luxemburg's view

requires the existence of non-capitalist modes of production. However, as capitalism enters into contact with non-capitalist areas, it progressively transforms them. This process reaches its limit – and the capitalist mode of production enters into crisis – when no non-capitalist forms of production are left. Hilferding, in his book published in 1910, emphasizes the formation of joint stock companies and their role in accelerating the concentration and centralization of capital. As small capitalists are driven out, the economy falls increasingly under the control of cartels or monopolies. In this process, financial, industrial and commercial capital become bound together forming what Hilferding calls finance (as distinct from financial) capital (see FINANCE CAPITAL), which he saw as dominated by banks. As monopolies attempt to control the world market, they seek the support of finance capital for expansionist policies and for gaining control over certain markets through protectionism. Hilferding also views the DCs' export of capital as a way for finding profitable investment opportunities in the LDCs by taking advantage of their low wages and land rents. The progressive character of foreign capital is emphasized, although he was aware that this might lead to economic and political dependence.

Bukharin's key contribution, set out in two books on imperialism published during and after World War I, is to locate the study of imperialism within a world-system context. In his schema, a struggle takes place between the various competing parts of the world economy, which is composed of national economies and individual enterprises. Under his analysis, the development of a world economy is characterized by the growing international INTERDEPENDENCE of its national units through increasing international trade. This establishes SOCIAL RELATIONS OF PRODUCTION on a world scale and creates a new international division of labour. This emerging world system of production comprises a few centre countries and a 'periphery of underdeveloped countries with a semi-agrarian or agrarian system' (Bukharin, 1972 [1924]: 74). Bukharin dis-

agrees with Luxemburg's view that the main-spring of imperialism is the problem of overproduction and realization. Rather it is the search for higher profits which propels the search for new opportunities to export excess capital.

For Lenin, in his 1917 pamphlet, imperialism is dominated by finance capital and expresses the monopoly and highest stage of capitalism (1996 [1917]). His analysis was influenced by the liberal and reformist economist J.A. Hobson (see below), as well as by Hilferding and Bukharin. Lenin likewise viewed the world as being divided between rival capitalist powers. He considers the export of capital from the capital-rich advanced countries as the economic basis of imperialism. This export of capital is driven by inter-imperialist rivalry in gaining control of and secure access to raw materials, as well as reaping the benefits of high profits arising from investments in the capital-poor countries. Profits are high because wages are low and the price of land and raw materials is relatively low. This export of capital leads to the spread throughout the world of capitalist relations of production in which power is concentrated in finance capital.

Lenin fiercely attacked KARL KAUTSKY's view of imperialism. Kautsky believed that a peaceful resolution of imperialist conflicts was possible and that it was in the interest of the major capitalist countries to cooperate and seek a peaceful settlement to their rivalry. Contrary to Lenin he believed that monopolization, by dispensing with competition, would lead to the demise of inter-capitalist rivalry. He expected competing capitalist factions to be brought under control through the dominance of finance capital. Thus capitalism could dispense with imperialism under the hegemony of a united international finance capital which he referred to as 'ULTRA-IMPERIALISM'. Kautsky thought that the external threat of the oppressed colonial peoples and the internal threat of the indigenous working class would persuade capitalist groups to agree to a joint framework for maintaining the world-system of exploitation which was so clearly to their

advantage. Lenin, by contrast, was convinced that inter-imperialist rivalries would become more intense as the scrambles for colonies had been exhausted and new forms of imperialist expansion had to be found. The likely outcome was not only war but the collapse of capitalism, opening up possibilities for a transition to socialism. Thus a peaceful resolution of the imperialist rivalries was not in the interest of socialist forces in society.

Non-Marxist theories of imperialism

J.A. HOBSON's theory of imperialism, advanced at the turn of the century, had a major influence on non-Marxist as well as Marxist writers. Hobson, a social-liberal economist, argued against imperialism on economic and political grounds. Imperialism was economically parasitic and harmful for democracy at home and for the colonial peoples abroad. In Hobson's view, imperialism arises out of the need to export capital given the insufficient outlets in the DCs. The expansion of monopolies results in larger profits being accumulated in fewer hands and the resulting increase in savings cannot find an outlet in the domestic market due to limited internal demand. To secure markets abroad and safeguard investments abroad, the advanced countries are driven to colonize undeveloped countries. Thus, for Hobson, imperial expansion and capital export originate from underconsumption arising from the unequal distribution of income.

Joseph Schumpeter, writing at the end of World War I, argued that imperialism is not an important force for the development of capitalism in the DCs. Schumpeter was critical of Marxist texts on imperialism. For him, imperialism is a survival of past historical forces which have no place in capitalism, as it prospers best under free-market conditions and does not require imperialism for its development. The modern production of commodities and development of markets has brought about democratic forces, individual freedoms and rationality, which were all contrary to the atavistic and regressive impulses of

imperialism. Thus modern capitalism would sooner or later destroy the irrational feudal elements and with it monopolies, wars and imperialism.

In the early 1950s, J. Gallagher and R. Robinson proposed the notion of 'the imperialism of free trade' which has some similarities with Hobson's idea of internationalism. According to them, those LDCs that were not colonies or those LDCs that had achieved independence in the early nineteenth century (such as much of Latin America) were still part of an informal empire. For example, Great Britain was able to exert its influence and control over a number of such countries by informal means in addition to its formal empire in Africa, Asia and the Caribbean. In this way, Great Britain was able to extend its empire 'on the cheap' by advancing its economic and political interests informally through free trade, rather than through more costly and risky direct rule and control. This theory of the 'informal empire of free trade' has the advantage of going beyond colonialism. It also shifts the analysis from an exclusive focus on the imperial country to an examination of the internal social and political system of the LDC, as – to secure such favourable trading links without direct control – the imperial power had to seek out and establish close relationships with willing local collaborators (see also COMPRADORS).

A structural theory of imperialism is developed by JOHAN GALTUNG (1971). He defines imperialism as a special type of domination by a centre country over a peripheral country which is characterized by dependency. The structure of imperialism divides communities, linking some parts in relations of 'harmony of interest' and others in relations of 'disharmony or conflict of interests'. A harmony of interests exists between the dominant groups of both centre and periphery, as the dominant groups in the periphery in turn constitute the centre of the peripheral country. Meanwhile, a disharmony of interest endures between the centre and periphery *within* each centre and peripheral nation, as well as *between* the periphery of the centre nation and periphery of the periph-

eral nation. This has certain similarities to Lenin's thesis of the labour aristocracy, as Galtung argues that the working class in the centre countries benefit from the surplus profits generated by imperialism. In turn, the elites in the periphery countries benefit from the support of the centre of the centre countries in maintaining their internal relations of exploitation and domination.

Galtung distinguishes five types of imperialism: economic, political, military, communications and cultural imperialism. Each is characterized by asymmetrical relationships between the centre and the periphery. While such relationships permit some form of democratic regime in the centre nations, they often require authoritarian types of domination in the periphery. Furthermore, Galtung expands his model of imperialism by introducing the idea of intermediary nations which act as bridgeheads and facilitate the flow of asymmetrical interactions between the centre and the periphery countries. For example, Mexico acts as an intermediary nation between the United States and the Central American countries and Japan performs this function on behalf of the United States and the South-East Asian periphery.

In short, Galtung's theory of structural imperialism can be seen as combining non-Marxist and Marxist theories. It is devoid of the economic reductionism of some Marxist interpretations of imperialism, while at the same time being influenced by STRUCTURALISM and DEPENDENCY THEORY.

Beyond imperialism

Following the national liberation struggles and the process of decolonization after World War II, imperialism was redefined to refer to forms of world capitalist domination under the hegemony of the United States. For example, BARAN and Sweezy sought to revise the Marxist theory of imperialism to take account of the latest phase of monopoly capitalism under the hegemony of the United States and the rise of MULTINATIONAL CORPORATIONS (MNCs). Terms like neo-imperialism and

NEO-COLONIALISM were more frequently used than hitherto, indicating a shift in the analysis of imperialism. However, such an extension of the theory of imperialism can be interpreted as leading to semantic confusion and to an analytical impasse.

Since the 1960s and 1970s, the theory of imperialism has largely been subsumed under dependency, UNEQUAL EXCHANGE and WORLD-SYSTEMS THEORY, and more recently by INTERNATIONAL POLITICAL ECONOMY (IPE). The neo-Marxist dependency theory, in particular, sought to overcome the EURO-CENTRISM of classical Marxist theories of imperialism, as these had centred their analysis on the imperial countries paying little attention to the internal structures and processes of the dominated countries. Finally, since Hobson's and Lenin's classic texts, imperialism has been condemned as parasitic. Bill Warren (1980), in a scathing attack on the Leninist view of imperialism and of neo-Marxist dependency theory, attempted to reassert an orthodox Marxist position in which imperialism is seen as a progressive force which integrates the underdeveloped countries into the world market and fosters their development. Warren, thereby, turns ANDRE GUNDER FRANK's thesis of the DEVELOPMENT OF UNDERDEVELOPMENT on its head. While the various theories of imperialism have their strengths and weaknesses, they made a valuable contribution to the debate on capitalism.

See also:

colonialism; dependency theory; imperial neglect and underdevelopment; internal colonialism; neo-colonialism; post-colonialism; ultra-imperialism; world empire

References and further reading

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import controls

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CRISTÓBAL KAY

import controls

Import controls include a range of quantitative restrictions to trade. The simplest and most pervasive of these are import QUOTAS which have been extensively applied to protect cars, textiles and clothing, and various agricultural industries (notably beef, rice and tobacco). They impose an upper limit on the volume or value of imports of a particular good or class of goods. A similar type of restriction is the market-sharing scheme which places an upper bound on the share of the domestic market supplied by imports. A content-protection scheme (or local content scheme) is a market-sharing scheme applied to inputs and requiring producers of a final good to source a minimum proportion of intermediate inputs from domestic producers. Such forms of import restriction have tended to proliferate as governments have lowered tariffs in the wake of successive rounds

of GATT negotiations (see GENERAL AGREEMENT ON TARIFFS AND TRADE).

All forms of quantitative import restrictions have similar effects. By restricting the imports of a good below the free-trade level, they create a shortage of the good on the home market and thus drive up the good's domestic price. This benefits domestic producers and workers, and also attracts resources of labour and capital into the sector from other parts of the economy where they are more efficiently employed (see PROTECTION COSTS; WELFARE ECONOMICS). Consumers buy a smaller total quantity of the good than before and pay a higher price for it. Because the domestic price of imports is above the border price, there is a premium attached to importing. This premium may accrue to importers if they are given import licences free of charge or they may accrue to the government if the licences are auctioned.

The effects of a quota closely resemble those of a tariff. In fact, if markets are competitive, there will be a tariff which has exactly the same effects on price, production and consumption as a given import quota. This is usually referred to as the 'tariff-equivalent' of the quota and it is often used by economists when estimating the overall level of protection associated with a mixture of tariffs and quotas. However, this simple equivalence of tariffs and import quotas breaks down when markets are not competitive. In particular, quotas are generally seen as inferior to tariffs when they are used to protect a domestic MONOPOLY. Under tariffs, the monopoly must compete with imports at the world price plus the tariff, putting an upper limit on the domestic price. In contrast, an import quota puts an upper bound on imports, enabling the firm to exploit its monopoly power. Thus, compared with a tariff, an import quota (and related types of import controls) gives a domestic monopoly greater market power and leads to a higher domestic price and lower consumption than under a tariff.

Import quotas tend to be favoured by import-competing producers because they insulate the domestic market from foreign price fluctuations. On the other hand, they make the

domestic industry more susceptible to sudden falls in domestic demand; under a tariff, a fall in demand is entirely reflected in a fall in imports, whereas under a quota, a fall in demand leads to a fall in domestic price and a contraction of the domestic industry.

It is usually easier to implement import quotas as a restriction on the volume rather than the value of imports. However, when a volume quota applies to a class of goods (for example, cars), this has the effect of distorting the mix of goods imported towards the more expensive goods in the class. This 'upgrading' effect of quotas has been empirically documented in several industries, including automobiles, textiles, clothing and footwear, and steel. In this and other respects, import quotas behave similarly to VOLUNTARY EXPORT RESTRAINTS (VERS).

See also:

commercial policy (CP); non-tariff barriers (NTBs); trade policy

Further reading

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NEIL VOUSDEN

import deposits

In some countries (such as Brazil and Chile), importers have to or had to deposit the purchase-money of a transaction in advance at a (central) bank. It is usually free of interest. If the transaction is accepted by the (central)

import substitution

bank and the payment is due, the bank provides the foreign exchange.

HELGE PEUKERT

import substitution

Import substitution is a strategy for ECONOMIC GROWTH and development which involves protecting domestic producers from foreign competition by levying TARIFFS and imposing QUOTAS on imports. The idea is to raise the price for domestic substitutes for the imported goods. The increased price provides greater incentives for production for the home market by domestic firms relative to production for foreign markets (exports). From a development perspective, the goal of such a strategy has been to promote the development of manufacturing and therefore transform the economy from an agricultural to an industrial base.

NEO-CLASSICAL ECONOMICS argues that FREE TRADE leads to an optimal allocation of resources both between and within countries. Thus all countries benefit via trade. However, a number of scholars have argued that in a world of highly developed and less developed nations, the latter are likely to be locked into the production of agricultural goods through free trade. Thus free trade would inhibit the industrial transformation of these countries. Newly established manufacturing firms in less developed countries are not likely to be able to compete against manufacturing firms in industrialized countries. This is because the firms in less developed countries are likely to operate at too small a scale and to lack complete understanding of manufacturing technologies. In other words, they are unable to benefit from the economies stemming from large-scale operations and from learning by doing.

The objective of import substitution strategies would be to protect infant industries in developing nations. The protection would allow these industries to expand operations so as to achieve ECONOMIES OF SCALE, as well as to give them time to learn. Once this process

was complete, these industries would be able to compete internationally without protection.

Unfortunately, in much of the world these policies have failed. Economies of scale failed to materialize and little learning seems to have occurred. As a result, the protected industries have failed to become competitive. Even more importantly, the protected industries have used much of their resources to accumulate political power allowing them to gain significant control over policy-making. This has been labelled as 'RENT SEEKING activities'.

In East Asia, however, import substitution has been a successful component of the policies used to promote rapid industrialization. Import substitution has been combined with EXPORT PROMOTION. Specifically, selected industries have been initially protected so as to promote rapid growth, but then, once the domestic market has been saturated, incentives have been tilted so as to promote production for foreign markets (exports).

The ability of East Asia to effectively combine import substitution and export-oriented development seems to be related to the effectiveness of the state in carrying out growth-promoting policies. Specifically, protection and subsidies were provided to infant industries. However, the resources were provided on a conditional basis. The firms had to use those resources in a productive way so as to become increasingly competitive. The measure of competitiveness often applied to these firms was the ability to export. If the subsidies provided by the state were not used productively, then they would be withdrawn. Thus productive use of the resources provided via protection was rewarded, while unproductive use of these resources was punished.

The key to successful import substitution, then, is linked to effective policy-making by the state. Research into the development of effective states is only just beginning. However, it seems that one critical factor is the investment in and development of human capital. Perhaps a second important factor in effective policy-making concerns the distribution of the benefits of growth. Effective government policy-making seems more likely in the context of a

growth strategy which widely distributes the gains in income.

See also:

export-led growth; export-oriented industrialization (EOI)

Further reading

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RICHARD GRABOWSKI

import substitution industrialization (ISI)

Import substitution industrialization (ISI) refers to a Southern development strategy designed to encourage the growth of home-grown manufacturing industries targeted at domestic markets. Through ISI policies, developing countries sought to break with colonial-era trade patterns that revolved around the exchange of South raw materials and agricultural produce for North manufactured goods. Instead, previously imported industrial products were to be replaced by domestically produced goods. It was hoped that the development of an indigenous manufacturing capability would lessen DEPENDENCE on the North, spur technological development, produce a better-rounded economic structure and support a higher standard of living.

ISI was originally adopted by many Latin American countries during the 1930s and early 1940s as a response to two major external economic shocks: the Great Depression (which eroded traditional export markets) and World War II (which interrupted the flow of consumer goods from the North). Initially out of necessity and later as a matter of conscious choice, Latin

American countries began to seek greater self-sufficiency and domestic industrialization.

The difficulty in pursuing such a course was that Southern firms were generally too small and inexperienced to withstand direct competition from Northern exporters. In an effort to nurture these infant industries, governments in the developing world raised protectionist barriers to stymie foreign competition. The first industries to be offered protection were producers of consumer goods, since the technical barriers and the capital requirements for this sort of production were lower. Due to the lack of experienced entrepreneurs, these firms were often state-owned and -managed. Besides tariff protection, the new firms were offered other forms of assistance, including subsidized financing and preferential access to foreign exchange. Where domestic industry lacked the knowledge or capital to engage in some types of production, Northern MULTINATIONAL CORPORATIONS (MNCs) were encouraged to jump protectionist barriers and to serve local markets through domestic production rather than exports.

Other policies were also associated with ISI. Purposefully overvalued local currencies cheapened the price of imported inputs such as oil, raw materials and capital goods for ISI industries. Rising wages were tolerated and social spending increased so as to encourage the growth of a domestic market for the consumer goods produced by ISI industries. Although cash-crop exports generated the foreign exchange needed for imported industrial inputs, overall investment was shifted from agriculture to industry and surplus rural labour was channelled towards urban areas.

ISI produced impressive growth and industrialization during the 1950s in much of Latin America and elsewhere. Yet, by the 1960s, ISI became plagued by internal contradictions. Once the potential for further growth in the consumer-goods sector slackened, governments began to pursue the 'deepening' of ISI by encouraging the development of manufacturing capabilities in basic and intermediate industries such as steel and capital goods. These investments involved larger scale commitments

inclusive democracy

of capital and more sophisticated technologies than had been the case in the consumer-goods industries, therefore requiring increased foreign borrowing or massive government spending. Moreover, since the domestic market for such goods remained small in many countries, new factories could not operate at efficient economies of scale, leading to high prices and large government subsidies.

ISI gave rise to debilitating rigidities. The justification for protecting the initial ISI industries from foreign competition was that they needed a breathing space until they attained sufficient size and experience to compete successfully on their own. In fact, many firms became dependent on protectionism and lobbied hard against lifting barriers. With little effective competition, these firms had few incentives to maximize efficiency or to carry out innovation. They were also free to charge monopoly prices.

Financial difficulties characterized the late stages of ISI. Government subsidies to industry and high social-spending led to large budget deficits. Foreign borrowing, the repatriated profits of multinational corporations and the discouragement of exports due to overvalued currencies led to external deficits and a growing debt. Rising wage levels, large budget deficits and the high prices associated with inefficient and monopolistic ISI industries created severe inflationary pressures.

In many developing countries, ISI fell into disrepute by the 1980s. In its place, many countries turned to a strategy commonly known as EXPORT-ORIENTED INDUSTRIALIZATION (EOI), which entails an emphasis on manufacturing production aimed at the international market, in contrast with ISI which focused on the domestic market. While the goal of ISI was to develop a well-rounded and relatively self-sufficient industrial economy, the goal of EOI is to exploit a country's particular advantages by finding a narrower, but profitable, niche in the world economy.

See also:

development; import controls; industrialization strategies

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DAVID SKIDMORE

inclusive democracy

Inclusive democracy is a new conception of democracy which, using as a starting point the classical definition of it, expresses democracy in terms of direct political democracy, economic democracy (beyond the confines of the market economy and state planning), as well as democracy in the social realm and ecological democracy. In short, inclusive democracy is a form of social organization which re-integrates

society with economy, polity and nature. The concept of inclusive democracy is derived from a synthesis of two major historical traditions: the classical democratic and the socialist, although it also encompasses radical green, feminist and liberation movements in the South (see FEMINISM; GREEN MOVEMENT; LIBERATION THEOLOGY). Within the problematique of the inclusive democracy project, it is assumed that the world at the beginning of the new millennium faces a multi-dimensional crisis (economic, ecological, social, cultural and political) which is caused by the concentration of power in the hands of various elites, as a result of the establishment in the last few centuries of the system of market economy, representative democracy and the related forms of hierarchical structure. In this sense, an inclusive democracy, which involves the equal distribution of POWER at all levels, is seen not as a utopia (in the negative sense of the word) but as perhaps the only way out of the present crisis.

The conception of inclusive democracy

A fruitful way to define inclusive democracy may be to distinguish between the two main societal realms, the public and the private, to which we may add an 'ecological realm', defined as the sphere of the relations between the natural and the social worlds. In this conception, the public realm – contrary to the practice of many supporters of the republican or democratic project (Hannah Arendt, Cornelius Castoriadis, Murray Bookchin and so on) – includes not just the political realm, but also the economic realm as well as a 'social' realm; in other words, any area of human activity in which decisions can be taken collectively and democratically. The political realm is defined as the sphere of political decision-taking, the area in which political power is exercised. The economic realm is defined as the sphere of economic decision-taking, the area in which ECONOMIC POWER is exercised with respect to the broad economic choices that any scarcity society has to make. Finally, the social realm is defined as the sphere of decision-taking in the workplace, the educa-

tion place and any other economic or cultural institution which is a constituent element of a democratic society.

It is therefore obvious that the extension of the traditional public realm to include the economic, ecological and 'social' realms is an indispensable element of an inclusive democracy. Correspondingly, we may distinguish between four main constituent elements of an inclusive democracy: the political, the economic, 'democracy in the social realm' and the ecological. The first three elements constitute the institutional framework which aims at the equal distribution of (respectively) political, economic and social power; in other words, the system which aims at the effective elimination of the domination of human being over human being. Similarly, ecological democracy is defined as the institutional framework which aims at the elimination of any human attempt to dominate the natural world. In other words, the system which aims to reintegrate humans and nature.

Political or direct democracy

In the political realm there can only be one form of democracy: what we may call political or direct democracy, in which political power is shared equally among all citizens. Political democracy is, therefore, founded on the equal distribution of political power among all citizens, the self-instituting of society. This means that the following conditions have to be satisfied for a society to be characterized as a political democracy:

- 1 That democracy is grounded on the conscious choice of its citizens for individual and social autonomy and not on any divine or mystical dogmas and preconceptions, or any closed theoretical systems involving natural or economic 'laws', or tendencies determining social change.
- 2 That there are no institutionalized political *processes* of an oligarchic nature. This implies that all political decisions (including those relating to the formation and execution of laws) are taken by the citizen

body collectively and without representation.

- 3 That there are no institutionalized political *structures* embodying unequal power relations. This means, for instance, that where authority is delegated to segments of the citizen body for the purpose of carrying out specific duties (for example, serving in popular courts or regional and confederal councils, and so on), the delegation is assigned, on principle, by lot and on a rotational basis, and it is always recallable by the citizen body. Furthermore, as regards delegates to regional and confederal bodies, the mandates should be specific.
- 4 That all residents of a particular geographical area (which today can only take the form of a geographical community) beyond a certain age of maturity (to be defined by the citizen body itself) and irrespective of GENDER, RACE, ethnic or cultural identity are members of the citizen body and are directly involved in the decision-taking process.

However, the institutionalization of direct democracy in terms of the above conditions is only the necessary condition for the establishment of democracy. The sufficient condition refers to the citizens' level of democratic consciousness, in which a crucial role is played by *paideia* (meaning not simply education but character-development and a well-rounded education in knowledge and skills – that is, the education of the individual as citizen, which alone can give substantive content to the public space).

The above conditions are obviously not met by parliamentary democracy (as it functions in the West), Soviet democracy (as it functioned in the East) and the various fundamentalist or semi-military regimes in the South. All these regimes are therefore forms of political oligarchy, in which political power is concentrated in the hands of various elites (professional politicians, party bureaucrats, priests, the military and so on). Similarly, in the past, various forms of oligarchies dominated the political domain, when emperors, kings and their courts, with or without the cooperation of knights, priests and

others, concentrated political power in their own hands. However, several attempts have been made in history to institutionalize various forms of direct democracy, especially during revolutionary periods (for example, the Parisian sections of the early 1790s, the Spanish collectives in the Civil War, and so on). Most of these attempts were short-lived and usually did not involve the institutionalization of democracy as a new form of political *regime* which replaces, and does not just complement, the state. In other cases, democratic arrangements were introduced as a set of procedures for local decision-making. Perhaps the only real parallel which can be drawn with respect to Athenian democracy is that of some Swiss cantons which were governed by assemblies of the people (*Landsgemeinden*) and, in their day, were sovereign states. The only historical example of an *institutionalized* direct democracy in which, for almost two centuries (508/7 BC–322/1 BC), the state was subsumed into the democratic form of social organization, is that of Athenian democracy. Of course, Athenian democracy was a *partial* political democracy. But what characterized it as partial was not the political institutions themselves, but the very narrow definition of full citizenship adopted by the Athenians – a definition which excluded large sections of the population (women, slaves, immigrants) who, in fact, constituted the vast majority of the people living in Athens.

Economic democracy

If we define political democracy as the authority of the people (*demos*) in the political sphere – which implies the existence of political equality in the sense of equal distribution of political power – then economic democracy could be correspondingly defined as the authority of *demos* in the economic sphere – which implies the existence of economic EQUALITY in the sense of equal distribution of economic power. And, of course, we are talking about the *demos* and not the state, because the existence of a state means the separation of the citizen body from the political and economic process. Economic

democracy therefore relates to every social system that institutionalizes the integration of society and the economy. This means that, ultimately, the *demos* controls the economic process, within an institutional framework of *demotic* ownership of the means of production.

In a more narrow sense, economic democracy also relates to every social system which institutionalizes the minimization of socio-economic differences, particularly those arising out of the unequal distribution of private property and the consequent unequal DISTRIBUTION OF INCOME and wealth. Historically, it is in this narrow sense that attempts were made by socialists to introduce economic democracy. Therefore, in contrast to the institutionalization of political democracy, there has never been a corresponding example of an institutionalized economic democracy in the broad sense defined above. In other words, even when socialist attempts to reduce the degree of inequality in the distribution of income and wealth were successful, they were never associated with meaningful attempts to establish a system of equal distribution of economic power. This has been the case despite the fact that, in the type of society which has emerged since the rise of the market economy, there has been a definite shift of the economy from the private realm into what Hannah Arendt called the 'social realm', to which the NATION-STATE also belongs. But it is this shift which makes any talk about democracy that does not also refer to the question of economic power ring hollow. In other words, to talk today about the equal sharing of political power, without conditioning it on the equal sharing of economic power, is meaningless.

On the basis of the definition of political democracy given earlier, the following conditions have to be satisfied for a society to be characterized as an economic democracy:

- 1 That there are no institutionalized economic *processes* of an oligarchic nature. This means that all macro-economic decisions, namely, decisions concerning the running of the economy as a whole (overall level of production, CONSUMPTION and INVEST-

MENT, amounts of work and leisure implied, TECHNOLOGY to be used, and so on) are taken by the citizen body collectively and without representation, although micro-economic decisions at the workplace or the household levels are taken by the individual production or consumption unit.

- 2 That there are no institutionalized economic *structures* embodying unequal economic power relations. This implies that the means of production and distribution are collectively owned and controlled by the *demos*, the citizen body, directly. Any inequality of income is therefore the result of additional voluntary work at the individual level. Such additional work, beyond that required by any capable member of society for the satisfaction of BASIC NEEDS, allows only for additional consumption, as no individual accumulation of capital is possible, and any wealth accumulated as a result of additional work is not inherited. Thus *demotic ownership* of the economy provides the economic *structure* for democratic ownership, whereas direct citizen participation in economic decisions provides the framework for comprehensively democratic control of the economy. The community, therefore, becomes the authentic unit of economic life, since economic democracy is not feasible today unless both the ownership and control of productive resources are organized at the community level. So, unlike the other definitions of economic democracy, the definition given here involves the explicit negation of economic power and implies the authority of the people in the economic sphere. In this sense, economic democracy is the counterpart, as well as the foundation, of direct democracy and of an inclusive democracy in general.

A model of economic democracy, as an integral part of an inclusive democracy, is described in the first book-length description of inclusive democracy (Fotopoulos 1997).

Briefly, the dominant characteristic of this model, which differentiates it from similar models of centralized or decentralized planning, is

that, although it does not depend on the prior abolition of scarcity, it does secure the satisfaction of the basic needs of all citizens, without sacrificing freedom of choice, in a stateless, moneyless and marketless economy. The preconditions of economic democracy are defined as follows:

- community self-reliance
- community (*demotic*) ownership of productive resources
- confederal allocation of resources

The third condition in particular implies that the decision mechanism for the allocation of scarce resources in an inclusive democracy should be based at the confederal rather than the community level, that is, at the level of the confederation of communities (*demoi*). This is in order to take into account the fact that in today's societies many problems cannot be solved at the community level (ENERGY, ENVIRONMENT, transportation, communication, TECHNOLOGY TRANSFER and so on). The mechanism proposed to allocate scarce resources aims to replace both the market mechanism and the CENTRAL PLANNING mechanism.

The former is rejected because it can be shown that the system of the market economy has led, in the last two hundred years since its establishment, to a continuous concentration of income and wealth in the hands of a small percentage of the world population and, consequently, to a distorted allocation of world resources. This is because in a market economy the crucial allocation decisions (*what* to produce, *how* and *for whom* to produce it) are conditioned by the purchasing power of those income groups which can back their demands with money. In other words, under conditions of inequality, which is an inevitable outcome of the dynamic of the market economy, the fundamental contradiction with respect to the market satisfaction of human needs becomes obvious: namely, the contradiction between the *potential* satisfaction of the basic needs of the whole population versus the *actual* satisfaction of the *money-backed wants* of part of it.

The latter is rejected because it can be shown

that centralized planning, although better than the market system in securing employment and meeting the basic needs of citizens (albeit at an elementary level), not only leads to irrationalities (which eventually precipitated its actual collapse) and is ineffective in covering non-basic needs, but it is also highly undemocratic.

The system of allocation proposed by the inclusive democracy project aims to satisfy the two-fold aim of:

- Meeting the basic needs of all citizens – which requires that basic macro-economic decisions are taken democratically
- Securing freedom of choice – which requires individuals to take important decisions affecting their own lives (what work to do, what to consume and so on).

Both the macro-economic decisions and the individual citizens' decisions are envisaged as being implemented through a combination of democratic planning – which involves the creation of a feedback process between workplace assemblies, community assemblies and the confederal assembly – and an artificial 'market' which secures real freedom of choice, without incurring the adverse effects associated with real markets. In a nutshell, the allocation of economic resources is made first on the basis of the citizens' collective decisions, as expressed through the community and confederal plans, and second on the basis of the citizens' individual choices, as expressed through a voucher system. The general criterion for the allocation of resources is not EFFICIENCY as it is currently defined, in narrow techno-economic terms. Efficiency should be redefined to mean effectiveness in satisfying human needs and not just money-backed wants. As far as the meaning of needs is concerned, a distinction is drawn between basic and non-basic needs and a similar one between needs and 'satisfiers' (the form or the means by which these needs are satisfied). What constitutes a need – basic or otherwise – is determined by the citizens themselves democratically. Then the level of need-satisfaction is determined collectively and implemented through a demo-

cratic planning mechanism, whereas the satisfiers for both basic and non-basic needs are determined through the revealed preferences of consumers, as expressed by the use of vouchers allocated to them in exchange for their 'basic' and 'non-basic' work.

Basic vouchers (BVs – allocated in exchange for 'basic' work, that is, the number of hours of work required by each citizen in a job of their choice so that basic needs are met) are used for the satisfaction of basic needs. These vouchers – which are personal and issued on behalf of the confederation – entitle each citizen to a given level of satisfaction for each particular type of need which has been characterized (democratically) as 'basic', but do not specify the particular type of satisfier, so that choice may be secured.

Non-basic vouchers (NBVs – allocated in exchange for non-basic work) are used for the satisfaction of non-basic needs (non-essential consumption), as well as for the satisfaction of basic needs beyond the level prescribed by the confederal assembly. NBVs, like BVs, are also personal but are issued on behalf of each community, rather than on behalf of the confederation. Work by citizens over and above the 'basic' number of hours is voluntary and entitles them to NBVs, which can be used towards the satisfaction of non-essential needs. 'Prices' in this system, instead of reflecting scarcities relative to a skewed income and wealth pattern (as in the market economy system), function as rationing devices to match scarcities relative to citizens' desires. that is, as guides for a democratic allocation of resources. Therefore prices, instead of being the cause of rationing – as in the market system – become the effect of it, and they are assigned the role of equating demand and supply in an artificial market which secures the sovereignty of both consumers and producers. The 'prices' formed in this way, together with a complex 'index of desirability' drawn on the basis of citizens' preferences as to the type of work which citizens wish to do, determine a 'subjective' rate of remuneration for non-basic work, in place of the 'objective' rate suggested by the LABOUR THEORY OF VALUE.

As the above brief description of the model of economic democracy makes clear, the project for an inclusive democracy refers to a future international POLITICAL ECONOMY which transcends both the political economy of STATE SOCIALISM, as realized in the countries of the ex-'actually existing socialism' in Eastern Europe, and the political economy of the market economy, either in its mixed economy form of the social democratic consensus or in its present neo-liberal form (see NEO-LIBERALISM: SOCIAL DEMOCRATIC PARTIES).

Democracy in the social realm

The satisfaction of the above conditions for political and economic democracy would represent the reconquering of the political and economic realms by the public realm – that is, the reconquering of a true social individuality, the creation of the conditions of freedom and self-determination, both at the political and the economic levels. However, political and economic power are not the only forms of power and, therefore, political and economic democracy do not, by themselves, secure an inclusive democracy. In other words, an inclusive democracy is inconceivable unless it extends to the broader social realm to embrace the workplace, the household, the educational institution and indeed any economic or cultural institution which constitutes an element of this realm.

Historically, various forms of democracy in the social realm have been introduced, particularly during this century, usually in periods of revolutionary activity. However, these forms of democracy were not only short-lived but seldom extended beyond the workplace (for example, Hungarian workers' councils in 1956) and the education institution (for example, Parisian student assemblies in 1968).

The issue today is how to extend democracy to other forms of social organization, like the household, without dissolving the private/public-realm divide. In other words, how, while maintaining and enhancing the autonomy of the two realms, can such institutional arrangements be adopted that introduce democracy to the

inclusive democracy

household and the social realm in general and – at the same time – enhance the institutional arrangements of political and economic democracy. In fact, an effective democracy is inconceivable unless free time is equally distributed among all citizens, and this condition can never be satisfied as long as the present hierarchical conditions in the household, the workplace and elsewhere continue. Furthermore, democracy in the social realm, particularly in the household, is impossible, unless such institutional arrangements are introduced which recognize the character of the household as a needs-satisfier and integrate the care and services provided within its framework into the general scheme of needs-satisfaction.

Ecological democracy

If we see democracy as a process of social self-institution in which there is no divinely or 'objectively' defined code of human conduct, there are no guarantees that an inclusive democracy would secure an ecological democracy in the sense defined above. Therefore the replacement of the market economy by a new institutional framework of inclusive democracy constitutes only the *necessary* condition for a harmonious relation between the natural and social worlds. The *sufficient* condition refers to the citizens' level of ecological consciousness. Still, the radical change in the dominant social PARADIGM which will follow the institution of an inclusive democracy, combined with the decisive role that *paedeia* will play in an environmentally friendly institutional framework, could reasonably be expected to lead to a radical change in the human attitude towards nature. In other words, there are strong grounds for believing that the relationship between an inclusive democracy and nature would be much more harmonious than could ever be achieved in a market economy, or one based on state socialism. The factors supporting this view refer to all three elements of an inclusive democracy: political, economic and social.

At the political level, there are grounds for believing that the creation of a public space will,

in itself, have a very significant effect on reducing the appeal of materialism. This is because the public space will provide a new meaning of life to fill the existential void that the present consumer society creates. The realization of what it means to be human could reasonably be expected to throw us back toward nature.

Also, at the economic level, it is not accidental that, historically, the process of destroying the environment en masse has coincided with the process of marketization of the economy. In other words, the emergence of the market economy and of the consequent growth economy had crucial repercussions on the society–nature relationship and led to the rise of the IDEOLOGY of growth as the dominant social paradigm. Thus, an 'instrumentalist' view of nature became dominant, in which nature was seen as an instrument for ECONOMIC GROWTH, within a process of endless concentration of power (see INSTRUMENTALISM). If we assume that only a confederal society could secure an inclusive democracy today, it would be reasonable to assume further that once the market economy is replaced by a democratically run confederal economy, the grow-or-die dynamics of the former will be replaced by the new social dynamic of the latter: a dynamic aiming at the satisfaction of the community needs and not at growth *per se*. If the satisfaction of community needs does not depend, as at present, on the continuous expansion of production to cover the 'needs' which the market creates, and if the link between economy and society is restored, then there is no reason why the present instrumentalist view of nature should continue to condition human behaviour.

Furthermore, democracy in the broader social realm could also be reasonably expected to be environment-friendly. The phasing out of patriarchal relations in the household and hierarchical relations in general (see PATRIARCHY) should create a new ethos of non-domination which would embrace both nature and society. In other words, the creation of democratic conditions in the social realm should be a decisive step in the creation of the sufficient

conditions for a harmonious nature society relationship.

Finally, the fact that the basic unit of social, economic and political life in a confederal democracy would be the community might also be expected to enhance its environment-friendly character. It is reasonable to assume – and the evidence of the remarkable success of local communities in safeguarding their environments is overwhelming – that when people rely directly on their natural surroundings for their livelihood, they will develop an intimate knowledge of those surroundings, which will necessarily affect positively their behaviour towards them. However, the precondition for local control of the environment to be successful is that the community depends on its natural surroundings for its long-term livelihood and that it, therefore, has a direct interest in protecting it – another reason why an ecological society is impossible without economic democracy.

A new conception of citizenship

The above conditions for democracy imply a new conception of citizenship: economic, political, social and cultural. Thus *political citizenship* involves new political structures and the return to the classical conception of politics (direct democracy). *Economic citizenship* involves new economic structures of community ownership and control of economic resources (economic democracy). *Social citizenship* involves self-management structures at the workplace, democracy in the household and new WELFARE structures in which all basic needs (to be democratically determined) are covered by community resources, whether they are satisfied in the household or at the community level. Finally, *cultural citizenship* involves new democratic structures of dissemination and control of information and culture (mass media, art and so on), which allow every member of the community to take part in the process and at the same time develop their intellectual and cultural potential.

Although this sense of citizenship implies a sense of political community, which, defined

geographically, is the fundamental unit of political, economic and social life, still it is assumed that this political community interlocks with various other communities (cultural, professional, ideological and so on). Therefore, the community and citizenship arrangements do not rule out cultural differences or other differences based on gender, age, ethnicity and so on, but simply provide the public space in which such differences can be expressed; furthermore, these arrangements institutionalize various safety valves that aim to rule out the marginalization of such differences by the majority. What, therefore, unites people in a political community or a confederation of communities is not some set of common values, imposed by a nationalist ideology, a religious dogma, a mystical belief, or an 'objective' interpretation of natural or social 'evolution', but the democratic institutions and practices that have been set up by citizens themselves.

It is obvious that the above new conception of citizenship has very little in common with the liberal and socialist definitions of citizenship which are linked to the liberal and socialist conceptions of human rights. Thus, for the liberals, the citizen is simply the individual bearer of certain freedoms and political rights recognized by law which, supposedly, secure equal distribution of political power; for the socialists, the citizen is the bearer not only of political rights and freedoms but, also, of some social and economic rights, whereas for Marxists the citizenship is realized with the collective ownership of the means of production. The conception of citizenship adopted here, which could be called a democratic conception, is based on the above definition of inclusive democracy and presupposes a 'participatory' conception of active citizenship, like the one implied by the work of Hannah Arendt. In this conception, political activity is not a means to an end, but an end in itself. It is, therefore, obvious that this conception of citizenship is qualitatively different from the liberal and social-democratic conceptions which adopt an 'instrumentalist' view of citizenship, that is, a view which implies that citizenship entitles citizens to

income elasticity of demand

certain rights which they can exercise as means to the end of individual welfare.

Applications

A well-developed body of knowledge already exists regarding inclusive democracy and its applications. Crucial matters such as strategy of transition to an inclusive democracy, the relationship of science and technology to democracy, the significance of the rise of irrationalism with respect to the democratic project, the interrelationship between culture, mass media and democracy, and class divisions today have all been explored in *Democracy & Nature: The International Journal of Inclusive Democracy* (see further reading).

See also:

Socioeconomic Democracy (SeD)

Further reading

A resource centre on inclusive democracy can be accessed at <http://www.inclusivedemocracy.org/>.

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TAKIS FOTOPOULOS

income elasticity of demand

The income elasticity of demand measures the responsiveness to changes in income of the

quantity of a product demanded. If income elasticity of demand is symbolized by ϵ_y , it can simply be defined as:

$$\epsilon_y = \frac{\text{percentage change in quantity demanded}}{\text{percentage change in income}}$$

If $\epsilon_y = +1.5$ it means that an increase in income of 1 per cent leads to a rise in quantity demanded of 1.5 per cent. If $\epsilon_y = -2$ it means that an increase in income of 1 per cent leads to a fall in quantity demanded of 2 per cent.

An **INFERIOR GOOD** is a good for which the income elasticity of demand is negative. As income increases, consumers tend to shift to higher quality models of goods – for example, from chops to steaks.

A **normal good** is a good for which the income elasticity of demand is positive. Goods for which the income elasticity of demand is between 0 and 1 are ‘inelastic’ normal goods or ‘necessities’. The quantity demanded increases less than proportionally when income rises. Examples are food and clothing. Goods for which the income elasticity of demand is greater than 1 are ‘elastic’ normal goods or ‘luxuries’. The quantity demanded increases more than proportionally when income rises. Examples are sporting goods and taxi services.

Summarizing, on the basis of the income elasticity of demand we can distinguish three different groups of goods:

- 1 inferior goods ($\epsilon_y < 0$),
- 2 necessities or inelastic normal goods ($0 < \epsilon_y < 1$) and
- 3 luxuries or elastic normal goods ($\epsilon_y > 1$).

M. PETER VAN DER HOEK

incorporation

The term ‘incorporation’ has taken on two different meanings in the literature: (1) entities take on corporate form through the process of *incorporation*, whereas (2) the *incorporation doctrine* refers to the application of the Bill of

Rights to the States by the Fourteenth Amendment.

Incorporation

Entities can take on a number of different organizational structures, several of which fall within the general category referred to as 'corporate'. Incorporation is the process used by an entity wishing to assume corporate status. 'Articles of Incorporation' are a document that the law requires as part of the incorporation process. This document includes certain information about the entity (for example, name, address, purpose, duration, number of directors) and must be filed by any entity wishing to be granted corporate status. Incorporators are the individuals who establish the initial corporate structure and are responsible for ensuring that the entity's corporate status is approved. Finally, when a state approves a corporation's status and authorizes its existence, it will often issue a Certificate of Incorporation.

Perhaps the one feature which most distinguishes corporations from other organizational forms is that the incorporation process produces a separate legal entity that has many of the same rights and duties as real people. Thus, while proprietorships and partnerships are indistinguishable from their owners, a corporation is separate from its owners and is legally authorized to act in its own name through duly appointed agents. There are a number of legal ramifications of incorporation, all of which relate back to this main feature. Among the by-products of incorporation are:

- 1 limited liability (the owners of a corporation are not liable for the debts of the entity itself);
- 2 double taxation (corporate income is taxed twice: once when it is earned by the entity and again when it is paid to the owners), and
- 3 continuous life (because the corporation is a separate entity, its life does not depend on the lives of its owners).

Incorporation doctrine

The first ten amendments to the Constitution of the United States are known as the Bill of Rights. These amendments protect US citizens against the federal government's interference with a number of rights or privileges. The original Bill of Rights said nothing about the state governments. Thus, there was nothing to prevent state governments from denying citizens the same rights that the federal government was prevented from denying citizens. In 1868, however, the states ratified the Fourteenth Amendment which includes the phrase: 'No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.' Via the incorporation doctrine, the US Supreme Court has held that the majority of the guarantees in the Bill of Rights limit state governments as well as the federal government. (It is the US Supreme Court that delineates the boundaries of the incorporation doctrine.) It should be noted that the incorporation doctrine is not absolute. For example, the guarantees of jury trials in civil cases and the indictment by grand jury have been held inapplicable in state cases. Over time, however, the Supreme Court's interpretation of incorporation has expanded, meaning that a greater number of guarantees in the Bill of Rights are held applicable against state and local governments.

See also:

law, economic role of

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STEVEN E. ABRAHAM

indebted industrialization

Indebted industrialization is the practice among DEVELOPING COUNTRIES of borrowing from private financial institutions to fund their state-led industrial development. In the late 1960s, as more and more developing countries in Asia and Latin America began to borrow from private sources, private bank lending replaced international aid organizations and multinational corporations to become their main source of foreign exchange. Moreover, money became increasingly available to developing countries as Middle Eastern oil exporters deposited their oil revenues in the largely unregulated eurodollar market. Among the biggest borrowers were oil-exporting and -importing countries such as Algeria, Argentina, Brazil, Mexico, South Korea, Taiwan and Venezuela. Borrowing by the state and state-owned enterprises seemed to give developing countries

more autonomy. It enabled them to set their industrialization agendas without having to sacrifice control to MULTINATIONAL CORPORATIONS (MNCs) and without the conditions of international organizations such as the INTERNATIONAL MONETARY FUND (IMF) or the WORLD BANK or unilateral aid donors. After the first oil embargo in 1973, developing countries faced with balance of payment deficits borrowed even more aggressively in order to sustain their industrialization efforts. Latin American countries like Brazil and Mexico, whose populist governments were reliant on working- and middle-class support, borrowed to maintain their IMPORT SUBSTITUTION strategies, attaining higher levels of economic growth than Europe and North America during the 1970s. As developing countries saw their production of manufacturing products increase, their ability to export these goods became a concern of international bankers whose loans had to be serviced with foreign exchange. Hence, indebted industrialization led to the development of a symbiotic relationship between international bankers and developing countries' elites. The second oil embargo in 1979 led to a world recession, increased protectionism in developed countries and soaring interest rates. Developing countries, which had been borrowing on floating rates, saw their exports earnings fall and debt burdens rise. In Latin America, the 1982 DEBT CRISIS exposed the shortcomings of import-substitution indebted industrialization. Most countries rescheduled their foreign debts after accepting politically painful IMF austerity programmes. By contrast, indebted industrialization in East Asia did not reach a crisis level because the export-led development strategy of countries such as South Korea and Taiwan had been a success. These countries were deemed competitive exporters and hence creditworthy. Moreover, in South Korea, only 40 per cent of the foreign debt was in floating rates, compared to over 70 per cent in Brazil and Mexico. In spite of the differences between regions, the stability of the world's financial system had been threatened by the strategy of indebted industrialization and eagerness of international

bankers to lend in the belief that countries cannot default. After these episodes of crisis and adjustment, indebted industrialization has lost clout as a strategy for development, in favour of policies more friendly to FOREIGN DIRECT INVESTMENT (FDI).

See also:

dependent development; less-developed country (LDC) debt management

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SANDRA L. SUÁREZ

indenture

An indenture is an agreement between two parties. The most common type in the past was between employee and employer. Indentured labour is generally associated with COLONIALISM. Labourers were bound to work for their employer for several years. They were poorly paid, work conditions were often atrocious, discipline was generally severe. Indentured labour persists in some parts of the world, especially in Asia.

The second type of indenture exists in contemporary bond markets. This agreement between issuer and investor, sometimes called the 'deed of trust', contains pertinent information, including the amount of the loan, the rate

of interest, the schedule of interest payments, the term of the bonds and call features (if any), among other things. The indenture is an assertion of property rights. Recent proposals to reform the global financial architecture have focused on qualifying these rights to allow for some form of financial reorganization rather than default.

LYN JAGGARD

indifference curves

Indifference curves are a graphical way of showing different combinations of two commodities which yield the same level of satisfaction to the consumer (or other actor). A map of indifference curves is strictly non-intersecting, with each curve corresponding to a different level of satisfaction. Normally the two commodities are imperfect substitutes for each other, so that the curves are convex to the origin (shown by '0'). Figure 5 shows the quantity of the two commodities, A and B, along the axes. Curves further away from the origin go with a larger amount of A and B, and so with a higher level of satisfaction.

When the actor is the government, A and B might represent hospitals and schools. If the government faces budgetary limits as to how much of A and B it can afford to buy, it might have to trade off an extra hospital at the expense of fewer schools. On the diagram, the budget constraint is usually shown by a straight line (b b), the end-points corresponding

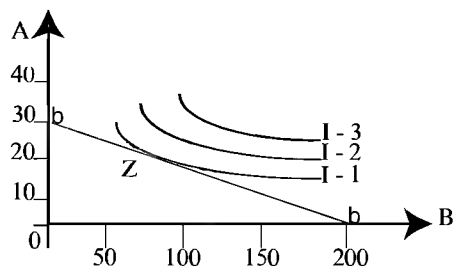


Figure 5 Indifference curves for A and B

individualism, methodological

to when all the budget is spent on A and B respectively. The goal is to maximize satisfaction by getting onto the highest attainable indifference curve without going beyond the budget line – that is, $I-1$ on the diagram. Point Z shows the rational choice – combination – of hospitals and schools – all this given the values embedded in the indifference curves and assuming that actors know what gives them satisfaction and can rank alternative combinations. These assumptions are vital to the concept of RATIONALITY used in NEO-CLASSICAL ECONOMICS.

Indifference curves are widely used in formal economic analysis. See a basic economics textbook for a fuller exposition.

DAVID LAW

individualism, methodological

Methodological individualism is a methodological approach to the study of social phenomena which emphasizes the influence of individuals over social wholes.

Contrary to methodological HOLISM (which emphasizes the influence of social groups), methodological individualism does not promote the study of social structures and social processes, but instead examines individual actions, attitudes, beliefs and so on, in order to explain social phenomena. For methodological individualism, social wholes are nothing more than an aggregate of the particular individuals which comprise them. For extreme methodological individualism, holism is a reflection of discredited idealistic social and political theories; social science should thus inquire into the motives and behaviour of individuals and treat social groups with reference only to individuals comprising them.

More moderate versions of methodological individualism accept the social nature of the individual, but redefine social science by reducing all explanations to terms of individual actions and beliefs, in spite of methodological holism's thesis that social entities cannot be

understood satisfactorily by studying only their components.

For many decades, the debate between methodological holism and individualism assumed the form of the critique by methodological individualists of a solid mainstream of social science (including economics) that was highly holistic in its approach. The situation has changed considerably since the first critiques of holism by MAX WEBER, Karl Popper or FRIEDRICH VON HAYEK. During the last two decades, the rational-choice PARADIGM swept over all other paradigms in the social sciences with unusual force, gaining momentum in economics but also in sociology, political science and law.

The RATIONAL CHOICE approach to social phenomena (which is reminiscent of egoistic hedonism) views individuals as rational maximizers with well-defined preferences. According to the theory, individuals act in ways that best satisfy their objectives. For a choice to be rational, a number of conditions must be met, such as reflexivity, completeness, transitivity and continuity. Rational-choice theory applies to any kind of behaviour, from the most altruistic to the most egoistic. By studying and explaining individual behaviour, rational-choice theorists explore the many forms of INTERDEPENDENCE among individuals.

In economics, the debate between methodological individualism and holism was framed by the controversy over the prevalence of micro- or macro-economics. Although for classical economics, macro-economic phenomena were studied as the aggregate of individual actions in the micro-economy, after the Keynesian revolution (see KEYNESIAN ECONOMICS) and for more than four decades, macro-economic mechanisms were the dominant paradigm in economics. However, after the success of the rational-choice (micro-economic) revolution in the social sciences and the parallel rejection of some of the Keynesian policies, micro-economics made a comeback as the dominant approach to economic phenomena. The consecutive editions of Samuelson's textbook testify to this gradual shift in paradigms in economic science.

Although rational choice is a spin-off of methodological individualism, it managed to bridge the gap between individual actions and macro-behaviour. Despite its narrow individualistic assumptions, the success of rational-choice theory is due to its simplicity, in comparison with its rich but also sluggish opponents, which may describe social phenomena in a more comprehensive way, but fail to explain and predict them as rational choice does.

The usual critique of methodological individualism in general is that the actions, motives, beliefs and attitudes of persons are decisively determined by culture and society, and that methodological individualism (including rational choice) cannot offer a theory of preference-formation. Further, methodological individualism is charged with being ideologically burdened, influenced by liberal individualism in its opposition to holism as a form of collectivism.

See also:

economism

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ARISTIDES N. HATZIS

industrial democracy

The concept of 'industrial democracy' is an old idea of Western civilization that through time has become both controversial and popular. The concept appeared in the latter years of the nineteenth century among the socialists of the trade-unionist movement as a radical criticism of capitalism, suggesting collective ownership of the means of production. The Fabian socialists Sidney and Beatrice Webb asserted a more social meaning to the term: associating the idea of democracy with industrial relations, they perceived industrial democracy as of the same kind as the democracy of the industrial factories, from the operational micro-democracies of the shopfloor to the political macro-democracy at the level of the society.

Alongside the development of the modern industrial system, the term became more popularized and was associated with the idea of democratization of society and the economy. The most immediate consequence was its linkage to the idea of worker participation in the life of a company.

By the end of the twentieth century, that concept gained a more specific significance, designating the idea and practice of cooperation between capital and workers, in order to help them work in common undertakings. Industrial democracy seeks to overcome social divisions in industrial work, reducing hierarchical differences in the production process in order to establish mutual consent. In this manner, industrial democracy has also been associated with the most recent participatory managerial practices, as well as being used as a

industrial organization (I/O) theory

synonym for terms such as participation, empowerment, flexibility and teamwork.

See also:

post-Fordism

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LUÍS ANTONIO CARDOSO

industrial organization (I/O) theory

Industrial organization (I/O) theory is the study of imperfectly competitive markets and the behaviour and operation of the participating firms. Developed as an offshoot of traditional micro-economic theory, the pioneering I/O work of the 1940s and 1950s was based on the structure conduct performance (SCP) paradigm. This method stressed the direct relationship between the market structure, the participating firm's conduct and its market performance. Researchers looked to uncover empirical regularities in the SCP relationship that existed across industries.

Modern industrial organization theory is far more dynamic than its SCP predecessor. Building on the non-cooperative GAME THEORY of the 1970s, modern I/O theory emphasizes the strategic interconnections present between firms. Current I/O theory attempts to create a coherent model of the *tactical* (short-run reactions to current market conditions) and *strategic* (long-run market-altering) components of market activity. Modern I/O theory

also stresses the powerful influence of the government in firm behaviour.

MICHAEL C. CARROLL

industrial policy

Given the extensive role and impact of modern governments in the economies of their societies, 'industrial policy' is difficult to define or demarcate with any precision. A working definition of industrial policy might, however, be any governmental policy that is explicitly intended to influence a country's industrial capability and/or competitiveness.

Direct governmental control of industry is the most dramatic form of industrial policy. The decades immediately following World War I saw many European governments take direct control over key industries. Such control, it was believed, would ensure that countries retained industrial innovativeness and general capacity in areas that were deemed to be central to military strength and/or future economic competitiveness. Direct control of key industries, it was believed, should also check the emergence of overly powerful industrial combines that might, as had happened in Nazi Germany, become complicit in dangerous political and military developments.

Direct governmental ownership and control of industry has become less popular with the triumph of liberal free-market principles (see LIBERALISM; FREE TRADE). Primary industrial policy can, however, also include governmental action to shape industrial structure or provide various forms of support for specific industries and enterprises. During the inter-war years, the British government embarked on a policy of consolidation of the country's chemical industry that led to the creation of the giant Imperial Chemical Industries. Grants and tax breaks for RESEARCH AND DEVELOPMENT (R&D) have also been widespread, if increasingly controversial. The European AIRBUS CONSORTIUM secured substantial financial support from the governments of participating European countries during the years since its foundation.

Policies of advice, encouragement and support have also been available for many countries' industries through their respective departments of trade and industry. Many of the rules and regulations promulgated by governments also have significant implications for the structure and functioning of various industries: the allocation of broadcasting frequencies has a profound effect on the structure of radio, television and mobile communications industries; the regulation (or lack of regulation) of financial services influences the character of countries' financial services industries; health-and-safety legislation impacts substantially on a range of industries and enterprises, including factories, retail services and the building trade; controls on the use and availability of land condition the geographical location of industry and retail services and limit the opportunities for the construction industry.

Many neo-mercantilist practices (see NEO-MERCANTILISM) are also designed for the direct benefit of various home industries. The economic industrial development of all the NEWLY INDUSTRIALIZED COUNTRIES (NICs) of South and East Asia has been cushioned by extensive restrictions on competitive imports that were lifted only under considerable external pressure and after strong local industries had been established. Many new industries within the region also benefited considerably from direct governmental subsidies and/or the encouragement of supportive links with large financial institutions and leading governmental members. Well honed industrial policy can thus play a major role in the early industrial development of societies that would otherwise be vulnerable to competitive pressures from better established industrial nations; poorly devised and implemented governmental policies, however, can have catastrophic economic consequences, as exemplified by much of the former Soviet bloc and broad swathes of SUB-SAHARAN AFRICA (SSA).

The problem with industrial policy, however, is to delineate its boundaries. Policy in many areas has had clear and intentional implications for the industrial performance of different countries. German governments encouraged

the foundation of numerous departments of chemistry in its universities in the nineteenth century as a means of stimulating the emergence of a powerful chemical industry and, through it, the development of munition-production capability. British governments, on many occasions since the second half of the nineteenth century, held official enquiries into the health and effectiveness of technical education and training within the United Kingdom and its association with the retention of industrial competitiveness. Even more widely, governments have often lent their weight to the introduction and development of new sports, or sought to influence religious developments, as means of securing more vigorous and disciplined work forces (and military personnel).

The difficulty of demarcating industrial policy becomes even greater when industrial well-being is identified directly with the achievement of other desirable social or economic goals. Regional policy is particularly problematic in this respect. The need for vigorous regional policies has often triggered a pattern of industrial decline within the affected regions. Maintaining, reviving or replacing local industries has thus often been seen as central to the effective restoration of the local economy. Grants, tax breaks and other forms of financial support have thus frequently been aimed at economically troubled regions, with mixed effects: sometimes providing much needed breathing space for industries under pressure; sometimes encouraging the emergence or relocation of new industrial ventures; but sometimes doing little more than throwing good money after bad or prompting dowry-chasing behaviour by avaricious businesses. Such region-focused policies continue to be practised by the governments of most advanced industrial countries, however, including the EUROPEAN UNION (EU) through its structural and cohesion policies.

Industrial policy is thus difficult to demarcate with precision, is increasingly criticized in a world of NEO-LIBERALISM and has a mixed record in practice. Given the centrality of many industries to the economic well-being of modern societies, their close interconnection

industrial revolution

with a range of other legitimate concerns of contemporary governments and their critical role in the maintenance of military capabilities, it is unlikely that governments will abandon industrial policies of any or all kinds.

See also:

competition state; developmental state; economic realism; regulation

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R.J. BARRY JONES

industrial revolution

Industrialization is characterized by the change in an economy from being primarily agrarian to being more capital-intensive. Such a transformation occurred in Western Europe and North America during the eighteenth and nineteenth centuries, when the so-called 'industrial revolution' changed the way in which the world produced its goods. With regard to technology, the biggest advances arose from the introduction of steam power and new fuels (such as coal and petroleum) which were used in the new steam engines. This revolutionized

many industries, including textiles and manufacturing. It also enabled the transformation of many societies from being mainly agricultural to being ones in which industry and manufacturing were pre-eminent. One result of this was the growth of cities, as many formerly agricultural workers migrated to the cities to look for work in the new developing industries. In this way, the industrial revolution had a fundamental impact on the nature of society. Although the term, 'industrial revolution' originated in France, it really came into popular parlance with Arnold Toynbee's *Lectures on the Industrial Revolution* in 1884.

The industrial revolution began in Great Britain, taking place there roughly between 1760 and 1830. The requirements for successful industrialization were already in place by the time the process of industrialization began, with no major hindrances to the movement of workers from non-industrial to industrial occupations. As well as this, transport and communications were relatively cheap and efficient, given Britain's position as an island nation with a network of waterways. The steam engine replaced the more traditional power generated by windmills and watermills, allowing workers to be concentrated in mills where new machines could produce much larger quantities of manufactured goods. At the time, Great Britain was the most powerful state in the world, bolstered by its access to raw materials through its policies of colonization, and the industrial revolution enhanced the already predominant position of Great Britain in the international system. By the middle of the nineteenth century, a time when the country was probably at its most powerful, Great Britain was producing around 50 per cent of the world's iron and coal, and consuming just under half of the world's raw cotton output. Its energy consumption from sources such as coal and oil was five times greater than that of the United States and over a hundred and fifty times that of Russia. In addition, Great Britain was responsible for 20 per cent of world trade and for 40 per cent of the world's trade in manufactured goods. Coupled with this, Great Britain's position with regard to naval resources

was pre-eminent, with over a third of the world's merchant marine under British control, a share that continued to increase. In the six years between 1782 and 1788, for example, British merchant shipping more than doubled. Such growth was spurred on by the impact that the industrial revolution was having on consumer-demand both at home and abroad, and was aided by a spate of new inventions. With this economic background, the British government felt that it could play a more active role abroad when national interests demanded it.

Britain's increasing industrial power was not, however, arranged such that it would give the state fast access to the tools of war. Rather, the dominant liberal ideology in British economic thought – an ideology that had, incidentally, burgeoned alongside early industrialization – extolled the virtues of low government expenditure (particularly on defence) and the reduction of state controls over both the economy and the individual. Indeed, it can be said that the British subordinated their entire foreign policy stance at this time to aims derived from economics.

After its adoption in England, other countries such as France, Germany and the United States joined in the industrial revolution, although it must be said that the industrialization that occurred in these countries began from a much lower base than in Britain. Two decades of war had left a heavy legacy, and there was neither capital or local demand to produce a transformation on the scale that Great Britain had achieved. Thus, although the steam engine, the power loom and the railway made some headway in mainland Europe, the traditional features of the economy in large part still remained; thereby agriculture maintained some of its superiority over industrial production. In Italy and Greece, for example, people stayed longer on the land. Industrialization in these countries only really took off after World War I. The end results, then, of the industrial revolution were in these countries less dramatic than in Britain.

One interesting point to note here is that the pattern of industrialization in nineteenth-century Europe closely mirrored the geological

distribution of coal deposits. Coal was needed as the energy to fuel the new industrial inventions and, for this reason, industry grew up (for example) in the British Midlands and the north of England where there was plenty of coal, rather than in the south. Industry also developed in the north-east of France, not in the south-west for the same reason.

For non-European countries, the industrial revolution had a more damaging impact, as they sustained losses in both absolute and relative terms. In particular, countries such as India and China were faced with the staggering increases in production that resulted from the industrial revolution. For example, between the 1750s and the 1830s improvements in the spinning industry in Britain had increased productivity in that sector alone by as much as 300–400 times. Moreover, when other European states and the United States followed the British path to industrialization, their shares also rose steadily, as did their per capita levels of industrialization and their national wealth. The results of the industrial revolution in China and India were, however, quite different. Not only did they discover that their shares of total world manufacturing shrank in relative terms, simply because the West's output was rising so swiftly, but in some cases their economies declined absolutely: they deindustrialized, as a result of the penetration of their traditional markets by the far cheaper and better products that the industrialized economies in the West could produce. Such impacts were reiterated by the nature of colonial policies, under which cheap raw materials were exported from the colonies in order to feed the needs of industrialization in the West. Indeed, the idea of the industrial revolution being based upon Western exploitation has a long history, including the notion that the success of the industrial revolution in Britain rested on British exploitation of slavery in the West Indies.

Finally, the industrial revolution can be credited with changing the face of modern warfare. In particular, the industrial revolution made the waging of military and naval warfare more extreme, providing as it did the infrastructure for and capability to keep huge

industrial revolution, second

armies in the field. In the second half of the nineteenth century, in particular, railways, telegraphs, quick-firing guns, steam propulsion and armoured warships became decisive indicators of military strength.

See also:

decolonization; development; economic growth; liberalism; Marxism-Leninism; mercantilism; war

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ALISON M.S. WATSON

industrial revolution, second

After the longest period of deflation in modern history, the end of the nineteenth century saw a second industrial revolution in Europe and the United States. During the preceding century, the revolutionary advances of the first INDUSTRIAL REVOLUTION were fully incorporated into the organization of economic activity. Though improvements in productivity continued throughout the century, in the second half these technological breakthroughs were consolidated, without any further major innovations. However, in the twenty or so years before World War I a cluster of important technical developments led to a second acceleration of

economic growth, similar to that which followed the first industrial revolution. These emergent (though not necessarily absolutely new) technologies were electrically powered motors and other devices, organic chemistry and new synthetic materials, and the internal combustion engine. Alongside these advances, organizational innovations that resulted in precision manufacture and assembly-line production also contributed to this acceleration of ECONOMIC GROWTH. Meanwhile, a continuing decline in TRANSPORT COSTS resulted in lower food prices, as well as falls in manufacturing input costs, and enhanced the disposable income of most levels of society, widening the markets for manufactured goods considerably.

As well as technical advances, the second industrial revolution entailed innovations in the management of manufacturing companies. At this time, the modern industrial enterprise emerged, developing in three key directions: (1) ECONOMIES OF SCALE and SCOPE were explicitly engineered into the industrial process, (2) significant investment was therefore needed in marketing and distribution to ensure the volume of goods produced was sold, and (3) a managerial hierarchy was recruited to manage and coordinate present and future activities of the industrial enterprise. The second industrial revolution was therefore both a technical and organizational revolution, enhanced by the development of the nascent mass market. The economic momentum of this second revolution was only exhausted by the saturation of mass markets during the crisis of the 1970s.

See also:

Fordism, crisis of; Fordism, developmental model of; Fordism: mode of regulation; Fordism: regime of accumulation; technological change

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CHRISTOPHER MAY

industrial revolution, third

The impact of information technology on the late twentieth-century global economy has been termed by some analysts a 'third industrial revolution'. This revolution is sometimes seen as over, sometimes underway and unfinished. The third industrial revolution, if it exists, may be closely linked to GLOBALIZATION and more efficient communications; the latter being seen as, perhaps, the principal factor behind these changes.

Many proponents of this view suggest that computerization will continue to have many economic consequences. It may enable the increasing decentralization of work practices and so transform the structure of industrialized societies and facilitate collaboration between dispersed teams, thereby fragmenting processes of production, RESEARCH AND DEVELOPMENT (R&D), distribution and so on. Moreover, the emergence of new products, based on the ability to offer skills and services to a global market directly via computer links and to transfer funds rapidly worldwide, might create new markets and industries. There is some convincing evidence that many of the aspects of such a revolution already exist or are beginning to take shape (for example, the growth of global financial activity). The problems posed for individual states or firms in regulating activities and securing data in this new environment are acute, and the information economy resulting from these factors might offer prospects not only for greater prosperity but also for new risks (see INFORMATION

SOCIETY/ECONOMY). Foremost is an increasingly turbulent world economy, accelerated beyond control by electronic transactions, in which localized problems may cause global crises.

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KEN DARK

industrialization strategies

There are two types or strategies of industrialization: IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) and export substitution industrialization (ESI) or EXPORT-ORIENTED INDUSTRIALIZATION (EOI). In general, in an ISI regime, imports are substituted for domestic production, while in an EOI regime, priority is given to export-oriented industries.

The ISI strategy was mainly developed and advocated by R. PREBISCH and H.W. SINGER, who were the first to observe the deterioration of TERMS OF TRADE for the LEAST-DEVELOPED COUNTRIES (LLDCs) *vis-à-vis* Britain since the last decades of the nineteenth century and the first of the twentieth. Considering that the gains from trade are structurally biased, Prebisch and Singer argued that this tendency

continues over time because technological progress in developed countries (DCs) reduces world demand for LDCs' primary products. The so-called 'ENGEL'S LAW' (that is, when world income increases a progressively lower percentage of it is spent on primary products) makes, according to the same authors, matters worse. Hence, the policy prescription is to erect productive barriers, by imposing either *TARIFFS* or *QUOTAS* on imports to make domestic production competitive and potential investments profitable. The 'infant' industries are then expected to emerge, diminishing the need to import consumption goods, and face balance of payments disequilibria. It is also expected that ISI would lead to a much more efficient industrial structure by creating backward and forward linkages and by implementing the 'learning by doing' process in 'infant industries'. ISI is believed to spur growth and contribute to the improvement of living standards in LDCs. ISI was implemented mainly in Latin American countries during the 1960s, with ambiguous results.

As far as criticism of it goes, the ISI strategy is accused of increasing import intensity but, as all the necessary inputs for 'infant' industries have to be imported, this reduces gains from trade and factors already in abundance in the country in question. ISI is also accused of having increased inefficient government intervention, bureaucratization, bribery and corruption.

On the other hand, EOI is a strategy that takes advantage of any national abundant resource, favouring the development of outward-oriented industries. As Professor Balassa, one of its advocates, points out, EOI leads to resource allocation according to *COMPARATIVE ADVANTAGES*, allows for greater capacity utilization, permits the exploitation of *ECONOMIES OF SCALE*, generates technological improvements and, in labour-surplus countries, contributes to increased employment. The aforementioned advantages, cited in the relevant literature, are all based on the rationale of the Ricardian theory of comparative advantage. According to this theory, shifting inputs into the production of the commodity for

which the ratio of domestic input-costs to foreign input-costs is lower, the benefits both domestically and internationally increase. Similarly, in Heckscher Ohlin comparative advantage theory, the factor in abundance determines the differences in comparative costs between two countries and highlights the sectors of production and industries in which a government has a relative advantage to develop. In other words the production costs in these industrial sectors are relatively low by world standards and hence the government should leave market forces to allocate resources and 'favour' export industries.

The policy prescription is thus the complete opposite of the one proposed by ISI advocates. *FREE TRADE*, instead of tariffs and quotas, is needed to promote trade, and efficient allocation of resources and welfare. Exporting industries should be subsidized and government intervention should be restricted to production services, infrastructure and so on. The 'Four Tigers' of South and South-East Asia are considered the best examples of a successfully implemented EOI (see *FOUR TIGERS (ASIAN)*).

De-verticalization and the vulnerability of industrial structure are said to be the main problems of this type and strategy of industrialization. Economies like the aforementioned 'Tigers' are closely connected to the global economy, facing the negative impacts of possible unfortunate fluctuations of the markets.

As pointed out, ISI and EOI strategies lead to different types of industrial development, as well as different policy prescriptions. However, a possible combination of these strategies has also been proposed. If the believed deterioration of terms of trade for LDCs' primary products is true, some ISI is needed to motivate domestic forces towards advanced and efficient industrial activities. However, this strategy should be implemented only in the short-term. After an initial period of subsidizing domestic industries, at a later stage 'infant' industries should be gradually left alone to face international competition, producing both for domestic and foreign markets. In other words, a third

strategy or type of industrialization is the sequential combination of the ISI and EOI.

Further reading

On export-led growth (export orientated industrialization): the publications by the Organisation for Economic Co-operation and Development (OECD) and National Bureau of Economic Research (NBER) below, exemplify the link between the theory of comparative advantage and the advocacy of trade liberalization.

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On import substituting industrialization: the articles below illustrate the links between theories of structural differences and asymmetric gains from trade, and propose policies for reforming the international economic order.

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THEODORE PELAGIDIS

infant-industry protection

Infant-industry protection is the temporary shielding of a new industrial activity from the forces of international competition until it is able to operate profitably. Its rationale lies in the existence of static ECONOMIES OF SCALE and dynamic economies arising from learning. Early exponents of infant-industry protection during the INDUSTRIAL REVOLUTION were ALEXANDER HAMILTON, JOHN STUART MILL and FRIEDRICH LIST. Since the 1950s it has come to refer predominantly to promotion of industries that are new to DEVELOPING COUNTRIES.

Without protection, a new firm may incur an initial loss because its unit costs are higher than those of established foreign producers. There are two principal reasons why this might occur. First, in low-income countries with small home markets, producers may be unable to benefit from scale economies. By sheltering the home market, protection helps to ensure that a minimum efficient production volume will be reached, thus assisting the new industry to overcome the scale problem and become competitive in export markets. Second, knowledge of a new technology is usually imperfect. Tacitness and complexity impede its effective transfer. There also tends to be considerable uncertainty about its performance in a new setting with different operating conditions and about local adaptations that may be needed. Therefore, mastery of complex new technology generally requires substantial learning, involving training, debugging, reverse engineering, adaptive RESEARCH AND DEVELOPMENT (R&D), and so on.

By itself, the need for technological learning is not a sufficient theoretical rationale for protection. If future profits are expected to be high enough to yield a discounted net surplus, private investors should be able to raise sufficient capital to cover the initial outlays if there are no market distortions. However, when MARKET FAILURE occurs in this situation, a wedge is driven between private and social returns, leading to private under-investment in the new industry from the point of view of

social WELFARE. For example, the benefits of the technological efforts of the pioneer firm may spill over to emerging competitors. Information leaks about successful adaptations that cannot easily be patented may induce copying, or a trained worker may be hired away by a rival firm. Such EXTERNALITIES reduce investment incentives in a new industry, which protection may help to offset. Another common form of market failure arises from poor information flows in developing countries. As a result, potential financial investors may view the emerging industry as too risky. By providing an assured market, protection reduces risk and lowers financing costs.

The scale and learning arguments for protection are often intertwined. For instance, a protected home market may lead to static unit cost reduction as well as faster learning through increased production. Another example is when home-market protection enables infants to use domestic profits for cross-subsidizing early exports. In addition to scale economies, this may give rise to learning through exposure to international competition and access to new technologies, ideas and market information. Although infant-industry protection has often been associated with IMPORT SUBSTITUTION, it can also be used to promote EXPORT-ORIENTED INDUSTRIALIZATION (EOI).

Strictly speaking, protection of infant industries can only be achieved through imposition of TARIFFS or QUOTAS, but SUBSIDIES are often also considered to be a protection instrument. Normative TRADE THEORY has established that subsidies are generally preferable to tariffs and quotas on efficiency grounds. A variety of other measures can also be used to nurture infants, but these do not lead to protection in the true sense. Yet, these measures tend to be more efficient than trade policies, because they intervene closer to the source of the distortion. They encompass, for example, public training subsidies, investment in public R&D infrastructure and education, and interventions to develop capital markets. Unfortunately, in developing countries such first-best measures are often too demanding in terms of policy-design capability and implementation

capacity. Tariffs and quotas are easier to use and have therefore been widely used in practice.

The measurement of maturation and the impact of protection on it are highly complex. The debate about definitions, methodologies and interpretation of results is far from settled. However, enough is known to conclude that the results of protection have generally been quite poor. In most countries, protection was extended for excessively long periods. Firms became complacent, colluding with one another to restrict output and keep prices high. They also paid more attention to RENT SEEKING activities than to learning and productivity improvement.

Nevertheless, there are some notable exceptions. In South Korea and Taiwan, where there is considerable evidence of infant-industry maturation even in technologically complex sectors with large economies of scale and long learning periods, governments made extensive use of tariffs and quotas, as well as export subsidies. In addition, they nurtured infants through preferential access to resources. However, unlike in most other developing countries, the support was temporary and conditional on firms' performance. Market forces were harnessed for enforcing economic discipline. Much emphasis was also placed on promoting technical education and on building up a public science and technology support infrastructure that could offer services relevant to the needs of new industries.

The reason why protection in these countries did not lead to complacency and continued dependence on public support appears to be that it was part of a much broader set of mutually reinforcing policy measures designed to shape an economic climate conducive to growth and continuous learning in the economy as a whole. This was in turn founded on a well-developed capacity for flexible, pragmatic and consistent policy-making and effective implementation.

See also:

East Asian model; import substitution; industrial policy; technological policy; technology transfer; trade policy

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HENNY ROMIJN

inferior goods

Inferior goods are those goods or services, the demand for which falls in total as the incomes and expectations of consumers rise. Thus, as the wealth of a community increases beyond a certain level, its population might begin to reduce its absolute level of consumption of a

foodstuff (for instance, an 'inferior' good like potatoes) while beginning to eat increasing quantities of more exotic vegetables. Inferior goods are thus subject to negative income elasticity of demand.

See also:

income elasticity of demand

R.J. BARRY JONES

inflation

Inflation is a process that distorts the allocation and distribution of scarce resources by both raising the general level of prices and by altering relative prices and returns. To some inflation means rising prices, while to others it means the falling value of money. It is both of these things, but neither side of this process is uniform. The unevenness of inflation distorts the allocation and distribution of scarce resources both within nations and among them, creating a few winners and many losers. Inflation may thus be considered a tax with a particularly opaque and uneven pattern of incidence.

Inflation was a visible and pressing macro-economic problem for advanced capitalist nations in the second half of the twentieth century. These nations experienced relatively high rates of inflation, especially during the turbulent decade of the 1970s. By the 1990s, however, inflation rates in advanced capitalist nations were relatively low and concern about inflation diminished. Inflation and the threat of hyperinflation remained an active concern, however, for many less-developed countries and economies in transition.

Almost everything about inflation is controversial. We begin with the least contested aspects and then move quickly into disputed territory.

Inflation and relative prices

Inflation is defined as a substantial, sustained increase in the general level of prices in an

economy. Individual prices rise and fall all the time in a market system. Only when there is a general upward trend in a broad measure of prices is inflation indicated. Inflation may also be defined as a decrease in the general purchasing power of money, which results from general price increases. A given quantity of currency purchases fewer goods and services over time during an inflationary period.

Nominal prices rise generally during an inflationary period, but real prices may rise, fall or remain constant. Both effects are important, but the change in real prices is harder to perceive, masked as it can be by rising prices in general. A nominal price is the quantity of local currency that must be exchanged for a resource. The real price is the amount of other scarce resources or general purchasing power that must be sacrificed to obtain an item. Inflation raises nominal prices and tends to distort the pattern of real prices. Suppose that nominal prices have doubled in an economy over a period of time. If the price of corn has exactly doubled along with the general price-level, then the real price of corn has not changed (it remains constant relative to the general level of prices). If the price of corn has increased faster than general prices, then its real price has increased. If the price of corn has increased less rapidly than the general price-level, however, its real price has fallen even though its nominal price has gone up. That is, less purchasing power must be sacrificed to purchase corn than before the inflation.

Moderate inflation would not be a very threatening economic problem if it were perfectly uniform, raising all nominal prices in equal proportion, but this never happens. For a variety of reasons the prices of some resources are more sensitive to inflation effects than others, so relative price distortions occur. Inflation can therefore create illusions that have important consequences. Rising nominal wages may actually represent a decrease in labour's return, if the nominal rise is less than the increase in the general level of prices. The illusion of more money is overshadowed by the reality of reduced command of real goods and services.

Measuring inflation

It is necessary to measure accurately the rate of inflation for three reasons: to assess the degree to which inflation is a macro-economic problem, to facilitate the calculation of real versus nominal values by economic agents, and as a guide to policies and programmes designed to compensate for inflationary effects through indexation (such as cost-of-living adjustments to wage and pension payments).

The inflation rate is measured using a price index, usually an index of prices of consumer goods. A consumer-price index is constructed by surveying household purchasing patterns and constructing a 'market basket' that reflects the types of goods and services that consumers typically purchase and the relative weights of these different commodities in consumer budgets. The specific market-basket items and their relative weights are then held constant while information is gathered about changing prices. Price indices are reported using index numbers, not local currency amounts, with the index set to 100 in the base year used, but the interpretation remains the same. An increase in the price-level from 100 to 105 signifies a 5 per cent inflation rate over that period of time.

It is very difficult to measure inflation accurately for two reasons. First, no individual actually experiences the consumption pattern used to construct the price-index market basket. Individuals and individual demographic groups may experience inflation rates that are significantly different from those calculated by the national price index. Inflation is also difficult to measure because actual patterns of consumer purchases tend to change over time, as income, tastes and relative prices change, while the goods and their weights in the price index must be held constant.

Errors in the measurement of inflation can have significant economic and social effects. It has been argued, for example, that price indices in the United States have since the 1970s systematically overstated the true inflation rate. If true, this error would have had several important effects, including unintentionally high payments to social insurance recipients

due to overgenerous pension benefit indexation. 'Technical errors' in price-index calculations may therefore have resulted in unintended resource redistribution (from tax-paying workers to pension-collecting retirees) and increased fiscal deficits, among other effects.

Effects of inflation

Inflation reduces the purchasing power of all who hold money but, as noted above, the effect is not uniform. Inflation therefore creates winners and losers, and it is this uneven incidence that is the most important consequence of moderate inflation (as compared with hyperinflation, which is discussed next). The most obvious burden of inflation falls on those who receive payments that are fixed in nominal terms, as is often the case with pensioners. Each increase in the general level of prices results directly in decreased purchasing power. Inflation also reduces the real incomes of those who receive payments that rise at a slower rate than overall prices, who pay taxes that rise faster than the general level of prices, or who consume items that are especially sensitive to inflationary effects.

Inflation has especially important effects on credit markets because changes in the general level of prices alter the purchasing power inherent in loan payments and bank balances. Unexpectedly high inflation rates, for example, are in a sense beneficial to borrowers who repay pre-existing loans with money that represents less purchasing power than was expected when the loan contract was signed. If the inflation rate exceeds the interest rate on the loan, the borrower may actually repay less total purchasing power than was initially borrowed. Unexpectedly low inflation, on the other hand, tends to be detrimental to borrowers, who find themselves making loan payments of greater purchasing power than they had bargained for because their money's value did not decline as rapidly as they expected.

Inflation is often compared to a tax and this is true in two respects. First, inflation does tend to increase government revenues (the inflation tax) in tax systems with progressive rate

structures. As wages rise along with other prices due to inflation's general effects, increased nominal income amounts are subject to higher progressive tax rates. Real tax collections tend to rise, unless the tax system is adjusted to prevent it, and the real disposable incomes of taxpayers fall. Second, inflation can also be seen as a tax in another way when the source of the inflation is excessive government money-creation. By increasing the money supply, the government claims purchasing power for its own use while reducing proportionately the purchasing power of all other money holders. Money creating inflation thus redistributes the ability to command scarce resources from the private sector to the public sector, just as a tax would do, but without the political and administrative problems of tax collection. If the rate of inflation is low enough, the tax effects may not even be apparent to citizens. Taxation through inflationary monetary debasement has unfortunately been a common practice through the centuries.

Hyperinflation

Very high and rapidly accelerating rates of inflation are called 'hyperinflation', although there is no firm line that divides high inflation from the hyper. During the post-World War I hyperinflation in Germany, Austria and Hungary, prices rose at rates of more than 100 per cent per day and, at the peak, 100 per cent per hour. The dizzying nature of price increases that characterize hyperinflation make money virtually worthless as a medium of exchange and credit or as a store of value. During the German hyperinflation, wheelbarrows of currency were needed to buy even a single loaf of bread. During the Bolivian hyperinflation of the 1980s, banks accepted currency deposits by the sackful, not bothering to count the bills since by the time they were tallied their value would have disappeared. Hyperinflation is a flight from money to real resources, a process that feeds on itself and grows.

The most important difference between inflation and hyperinflation is qualitative, not

quantitative. The allocation and distribution distortions caused by moderate inflation take place within an overall system of markets and governance that continues to work much as it would under a regime of stable prices. Hyperinflation, on the other hand, robs money of its practical utility and economic institutions that depend on relatively stable money-values grind to a halt. Normal markets tend to be replaced by barter arrangements. Banks and credit markets collapse. Even international trade comes to a halt. Hyperinflation destroys money and the institutions of money, which are the institutions of modern capitalism.

Hyperinflations usually end with a whimper, not a bang. The sophisticated economic system collapses, replaced by slow, basic and primitive barter arrangements. Money tends to disappear from use because no-one wishes to hold it, even temporarily. Eventually, government authorities are forced to replace the worthless old currency with a new currency unit (at a rate of perhaps 10,000 old bills for each new one) and then to rebuild the economic system and its institutions on the foundation of the new exchange medium.

Theories of inflation

There is no consensus within the economics profession regarding macro-economic theory and policy, and this fundamental disagreement extends to the issue of inflation. For simplicity, I will consider here two views, the monetarist perspective (that inflation is always and everywhere a monetary phenomenon) and a KEYNESIAN ECONOMICS perspective (which considers that there are many possible causes of inflation).

Monetarists (see MONETARISM) look at the price-level as being fundamentally determined by the balance between the supply of money, which is governed by the central bank, and the demand for money, which is determined by income, expectations and a number of other factors. If the supply of money increases at a faster rate than the demand for it, then 'too many dollars chase too few goods' and the price-level rises, reducing the purchasing power

of money. Monetarists view control of the money supply (the quantity of currency and liquid bank-deposits) as the key to controlling inflation. Monetarists advocate passive government economic policies, with an emphasis on steady predictable policies that do not disturb private market forces. The US monetarist MILTON FRIEDMAN, for example, proposed that the central bank forsake all discretionary action and instead steadily and moderately increase the money supply according to a fixed rule.

In recent years the monetarist theory of inflation has become increasingly concerned with expectations, how they are formed and what their impact is on economic behaviour. The argument is that self-interested and informed economic agents base their actions on expectations of future prices, wages, incomes and so on. Economic policies or events, such as a money-supply increase, can at best have temporary and transitory macro-economic effects (according to this line of thought) since expectations are soon adjusted and plans revised to compensate for the unanticipated shock. This analysis of expectations tends to reinforce the monetarist view that the economy is fundamentally stable and that, while activist government policies disturb this stability and risk creating inflation, they can have few lasting effects.

The Keynesian analysis of inflation considers that the price-level is determined by the interaction of 'aggregate demand' and 'aggregate supply', either of which may trigger inflation. Demand-pull inflation occurs when aggregate demand increases without an offsetting increase in aggregate supply, forcing price-levels up but also raising the level of national output. Demand-pull inflation may be caused by an increase in consumption, investment, government spending or net export spending. Cost-push inflation occurs when rising production costs (or the expectation of higher costs) cause a decrease in aggregate supply. Falling aggregate supply forces the price-level to rise while at the same time driving down national output, creating the 'STAGFLATION' that was observed in the 1970s.

Unlike monetarists, Keynesians tend to see the economy as unstable, buffeted by disruptive forces of all kinds. Wise government policy, including prices and incomes policy, can be an effective tool to 'lean against the wind', moderating macro-economic cycles and reducing the inflation and unemployment effects. Keynesians thus see many events that can cause inflation and many government policies that can potentially prevent inflation or reduce its impact.

Although there is no theory or policy consensus, it is fair to say that monetarist theory, with its contemporary focus on expectations and its bias against activist government policies, is currently the leading school of thought in the economics profession.

The political economy of inflation

The Phillips Curve is the idea that there is an inverse relationship between the rates of inflation and of unemployment; the notion was based originally on the empirical studies of New Zealand economist A.W. Phillips. The Phillips Curve inverse relationship suggests that there is a trade-off between inflation and unemployment: higher inflation rates are the price, in the short-run, of policies that reduce the unemployment rate.

The apparent existence of the Phillips Curve trade-off caused economists in the 1960s to adopt a decidedly activist and Keynesian stance towards macro-economic policy. It was thought that fiscal and monetary policies could be finely tuned to deal with changing economic conditions. If inflation rose too high, tighter monetary policy could bring it down (albeit at the cost of an increase in joblessness). If unemployment was too large, expansionary policies could be used to create jobs (although at a cost of higher inflation). Balancing inflation against unemployment, an activist government could prevent either problem from getting out of hand.

The idea of the Phillips Curve trade-off not only encouraged activist government policies, it also helped create a particular political economy of inflation. Special interests seeking

benefits from the government could gain jobs, for example, by advocating policies that were paid for through an inflation tax on other agents in the economy. It was in the interests of politicians and policy-makers to accommodate special interest pressures, since they would get credit for the specific benefits but could avoid blame for the general inflation costs. The existence of concentrated benefits (jobs or government payments) and highly diffused costs (the indirect effects of inflation) encouraged further special interest pressure, which succeeded by further raising the price-level. The political system was biased in favour of special interests and inflation, according to this analysis.

The monetarist critique of the Phillips Curve observes that the trade-off between inflation and unemployment appears to be at best temporary. Recent studies suggest that, while unemployment may be briefly reduced through policies that raise the inflation rate, no permanent decrease in joblessness is achieved. In the long-run, unemployment returns to the so-called 'natural unemployment rate' (see UNEMPLOYMENT, NATURAL RATE OF), raising or ratchetting up inflation in the process. The mechanism by which unemployment returns to its natural level involves expectations. Although unexpectedly high price-levels may influence employment decisions in the short-run, expectations adjust to higher inflation in the long-run and employment decisions return to their pre-shock patterns.

The logic of the monetarist opposition to activist government policies can be seen clearly in this analysis of the Phillips Curve. Since adaptive and rational expectations prevent government policy from having any permanent effect on unemployment, it makes sense to adopt instead policies that are moderate and predictable, that do not aim to shift the economy from its long-run path, but that also do not unnecessarily create costly inflation problems.

The idea that activist macro-economic policies can cause economic and political problems (inflation) but cannot create permanent benefits (jobs, etc.) seems to have altered the political

economy of inflation. It is in the interest of politicians and policy-makers to enter into agreements that prevent them from undertaking activist policies that create inflation but produce few permanent benefits. They may adopt constitutional constraints on monetary policy (New Zealand) or limits on budget deficits (widely discussed in the United States). They may alternatively enter into international agreements that impose constraints on monetary and fiscal policy, as many European nations have done in signing the MAASTRICHT TREATY and moving towards monetary union.

Further reading

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MICHAEL VESETH

informal economy

There is no generally accepted definition of the concept of the informal economy. The concept originates from the literature on DEVELOPING COUNTRIES, where it has been observed that large groups are not absorbed by the officially recorded market sector. These groups have to create their own employment system, leading to a variety of activities ranging from shoe-shining to illegal house factories such as breweries. In this sense, the concept of the informal economy

refers to small-scale, labour-intensive, low-income activities that remain unrecorded. Other descriptions of the informal economy can also be found in the literature, however. The lack of a generally accepted definition is illustrated by the plethora of terms used to describe the phenomenon of the informal economy, including 'unofficial economy', 'dual economy', 'underground economy', 'shadow economy', 'cash economy', 'subterranean economy' and so on.

Obviously, the informal economy is a phenomenon that is difficult to describe and define. It comprises a wide variety of activities ranging from work for a lump-sum labour subcontractor to domestic work. Virtually any activity that is undertaken in the formal economy can also be done in an informal way. Activities, transactions and income can all form elements of the informal economy. In particular, activities are often considered the main elements of any meaningful description of the informal economy. These activities are economic in that they generate income in one form or another. Some authors consider transactions also to be a main element of the informal economy. However, this would exclude all activities that do not lead to transactions, including the services of homemakers. Activities, transactions and income may be independent of one another. A more general description of the informal economy, therefore, recognizes that individuals undertake activities, which may or may not lead to transactions, which may or may not result in payments and which generate income in money or in kind.

A dentist may treat his neighbour for free, while his neighbour paints his house for free. Another example is someone who repairs his car himself rather than taking the car to an official service-station or to an engineer working in the black economy. These activities are in the twilight zone of leisure and labour. There is no formal transaction and there are no payments involved, but what these activities have in common is that they contribute to the welfare of those involved. Furthermore, these activities are unrecorded, unobserved and do not figure in any official statistic. Yet these

activities are perfectly legal and cannot be considered to be tax evasion. This emphasizes that the informal economy is a broad concept, even though a generally accepted definition is lacking.

A general characteristic of the informal economy is the lack of government control or regulation. The **BLACK ECONOMY** may be considered part of the informal economy, but some authors exclude the black economy from the informal sector. Activities in the informal economy do not necessarily lead to transactions. The informal economy also comprises a domestic/communal sector, where activities are undertaken that do not involve payments but that aim at cost-saving. Participation in the informal economy may enable households to maintain a certain standard of living, which may have a positive effect on the formal economy.

Obviously, the formal and informal economies are strongly interrelated. The informal economy may be an important source of **WELFARE** and well-being to individuals and households. Some sectors in the formal economy may need to scale down or may even be unable to survive without the existence of informal labour. Opportunities to participate in the informal economy are unevenly distributed over individuals and households. The most important determinants of participation are skills, financial means and contacts. Social inequality resulting from the formal labour market can thus be reinforced by the informal sector. On the other hand, however, the informal sector also offers opportunities to individuals and households who have little chance to participate in the formal economy.

M. PETER VAN DER HOEK

informatics

Social informatics refers to the study of the social aspects of computerization. This includes the design, operation and consequences of information technologies (IT), and their interaction with various institutional and

cultural contexts. Informatics emphasizes both the failure of simple technological determinism with regard to the implementation of IT and the necessity of creating a human-centred approach to system design. The subfield 'organizational informatics' examines the impact of socioeconomic incentive systems on the adoption of IT and the quality of working life within institutionalized settings. However, the widespread availability of computer resources outside organizations has led to research that contributes to debates on class divisions in society, Solow's 'productivity paradox,' democratization, employment, education, gender biases and military security.

Further reading

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CAMERON G. THIES

information society/economy

It has become commonplace to say that we live in an information society. Dating from the 1960s, social scientists and others have been referring to this as a new society characterized by the pervasiveness of computer-based technological developments. Precise definitions of the information society vary and these can be classified in terms of at least two general categories: technological and economic.

Technological definitions of the information society often are predicated on the widespread application of information-processing, storage and transmission capabilities through the convergence of computers with telecommunications. Through these mostly late-twentieth century developments, the per unit costs of producing, modifying and distributing most forms of electronic information have been dramatically reduced. At the same time, the

technical quality and the volume of information generated has risen significantly.

From this perspective, technologies that facilitate the use of electronic forms of information are having a profound impact on social and economic relations. From the late 1950s, American author Daniel Bell published articles and books – most notably *The End of Ideology* (1962) in which a post-industrial era was predicted. Technology, Bell argued, would compel the realization of unprecedented efficiencies which, in turn, would lead to significantly higher living standards. Assuming that such advancements and their implications for a post-industrial society would be shared by most, Bell believed that a relatively wealthy and person-centred service economy would emerge, at least in advanced industrialized countries. As new technologies made manufacturing more efficient, the ranks of a relatively affluent middle-class would swell. A mass recognition that technology itself constitutes the basis of an egalitarian and harmonious order would take root. Rational planning and science would triumph over irrational political conflicts as more and more people came to enjoy the fruits of technology.

Early sponsors of this 'end of ideology' thesis included the Congress for Cultural Freedom – an organization that supported intellectuals opposed to totalitarianism which was, in part, financed by the US Central Intelligence Agency. By arguing that anti-capitalist ideologies and scholarly perspectives – particularly Marxism – were on the wrong side of history, the legitimacy of voices refuting free-market systems generally and the American model in particular could be challenged.

In 1962, the year in which *The End of Ideology* was published, economist Fritz Machlup released *The Production and Distribution of Knowledge in the United States* (1962). For the first time, an attempt was made to measure the growth of the information economy. As of 1958, Machlup calculated that 29 per cent of US GROSS NATIONAL PRODUCT (GNP) came from industries that produced, distributed or manipulated knowledge. These included a broad range of activities – from

television broadcasting to insurance – and together they constituted the fastest growing segment of the US economy. By the end of the 1960s, the assumption that knowledge itself was the basis of wealth-creation became increasingly prevalent in both academic and popular discourse. Less than a decade later, the US Department of Commerce commissioned what would become a widely read report by Marc Porat (1977). It demonstrated that 46 per cent of American GNP was generated by what was classified as the 'information sector'.

Within two decades of the groundbreaking work of Bell and Machlup, the notion that relatively advanced industrialized countries were well on their way to becoming information societies had itself become nothing less than a kind of common-sense among policy-makers and the public. Among other sources, Alvin Toffler's airport bestseller *Future Shock: Introduction to America's Technological Miracle* (1970) helped elevate the information society into a kind of mythological ideal.

Underlying this status is a particular way of thinking about the relationship between technology and history called 'technological determinism'. Technological determinism is the view that technologies somehow shape human developments as much as (if not more than) people shape technologies. Put in another way, a technological determinist perspective considers machines to be agents of history.

Status quo academic, quasi-academic and journalistic writings on the information society and information economy developments tend to contain technological determinist assumptions. Because technology compels human action, information society/economy developments are thought to be inevitable, and because the future is already mapped out, states, corporations, organizations and individuals have no real choice other than to prepare for it as best as they can. Indeed, technological determinist assumptions, when they become (in Gramscian terms) the common-sense of the international political economy (IPE), often become self-fulfilling prophecies in that the very *idea* of the information society itself becomes an institutionalized reality. In part, it

is on this basis that public and private sector investments in information and communication technologies have grown substantially, particularly since the 1970s. Increasingly sophisticated and expensive technological upgrades involving the development and integration of computers and telecommunications have become routine expenditures. This state of affairs has had ongoing implications, not only for the world economy, but also for the day-to-day lives of individuals.

From a technological perspective, the information society is the result of the 'inevitable' development, convergence and application of computing and telecommunications. The role played by people generally has been passive in that humanity's appreciation of new technology is somehow rational and perhaps even natural. Information-based technologies are becoming increasingly pervasive in human lives because, quite simply, they make sense.

Economic perspectives

Another way in which the information society has been defined is more explicitly economic in its orientation and it often involves explicit references to what is commonly called the information economy. From this perspective, the findings of Machlup and Porat reflect an essentially economic, rather than technological, logic. Most influential in this have been academic and business-based views that computer and telecommunications developments facilitate greater efficiencies and flexibilities in the production process. Whether or not the public subsequently enjoy higher living standards is secondary to the obvious advantages that information-based technologies provide corporate interests. For example, manufacturers, if they invest in such technologies, potentially can locate production activities almost *anywhere* in the world where electrical power is available. Workers can be monitored more effectively. Information flows within and among corporations can be improved. Instantaneous and malleable information on production, distribution, exchange and consumption relationships can reduce inventory costs and

increase the effectiveness of marketing. Mass-production techniques can be replaced by increasingly customized goods for consumers. Moreover, new technologies can spawn an array of new economic activities in the service sector. Information can be generated, disseminated and manipulated in hitherto unimaginable ways, and the result will be a new era of capitalist growth.

Large-scale studies on the potential afforded by information-based technologies, particularly in the service sector, were instigated in the United States in the 1970s. This, while very much related to an emerging consciousness regarding the information society, was more fundamentally an outcome of the economic crisis facing both the US and other Western industrialized countries during that decade. The ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) cartel, the Vietnam War, the relative strength and wage demands of unionized workers, and the emergence of mostly Asian-based competitors, all contributed to the burgeoning demand for technological innovations that would significantly improve productivity and lower costs of production. Such innovations involved support by the American state (mostly through RESEARCH AND DEVELOPMENT (R&D) spending connected to the US military budget), the disciplining of unions (through Reaganomics, for instance) and the promotion of unprecedented competition in the computer and telecommunications industries.

Throughout the 1980s, the goals underlying such policies were achieved. New technologies were implemented to increase productivity and reduce costs. New information services improved turnover times for capital investments and, related to this, the ability of corporations to respond to consumer and market demands was improved. In sum, new technologies facilitated the free movement of all forms of electronic information. Lagging behind such technological capabilities, however, were international political and legal regimes that could facilitate their utilization. In the late 1980s, corporate America again became the agent of radical change. An information economy could only reach its full potential if, *first*, commercial

information is distributed with minimal interference from states; *second*, information (in all its forms) is treated like any other private good or commodity, and, *third*, a worldwide enforceable treaty is established that would provide information with the kinds of property rights already afforded to most material goods. The outcome was a concerted effort, chiefly promoted by transnational corporations and mediated by the American state, to establish comprehensive international trade agreements that focused on services and intellectual property rights. These efforts reached their zenith in the URUGUAY ROUND of the General Agreement on Tariffs and Trade, culminating in the establishment of the WORLD TRADE ORGANIZATION (WTO) in the 1990s. Among other things, the WTO now provides the producers and distributors of information with trade-based retaliatory mechanisms through which markets can be penetrated and remuneration for almost all forms of commercial information can be secured (Comor, 1998).

This history, involving the efforts of particular interests, belies technological determinist versions of information society/economy developments. As Robert Keohane and Joseph Nye have commented, 'information does not flow in a vacuum but in political space that is already occupied' (1998: 84). The information society/economy that Bell and many after him deemed to be little more than the rational expression of the inherent logic of technological applications is a myth. More precisely, the information society/economy – both in image and practice – has been the manifestation of mostly status quo interests faced with political, economic and ideological challenges.

From the perspective of LEAST-DEVELOPED COUNTRIES (LLDCs), a far more critical perspective towards information society/economy developments has long played an important role in the shaping of international economic development. As Hamid Mowlana points out, the diffusion of technology also involves 'the diffusion of the ideas and concepts behind [it]' (1975: 77). In addition to its cultural implications, information society/economy developments have been regarded as a plank in the general

deepening of asymmetrical core-periphery economic relationships. In the face of recent international free-trade agreements and rapid technological diffusion, however, LDCs have become more accepting of foreign corporate investment and modernization strategies in which information and communication technologies play central roles. Whatever their implications, such strategies often place far too much weight on technologies as the agents of change and development. Not only are information society/economy developments being promoted throughout the world using technological determinist arguments, concerns about the use of information and communication technologies to deepen North-South dependency relationships generally have been dismissed (Sussman and Lent, 1991).

Defining information

Defining and understanding information society/economy developments in either technological or economic terms is inherently problematic. This can be appreciated when we try to measure or assess the subject at hand – information. If claims that an information society (or information economy) has arrived are to be validated, information itself must be quantifiable. Any analysis of information developments and their implications therefore, first and foremost, involve a theorization of information itself. One common way to do this is to recognize information to be a component of individual and group knowledge (that is, of what is 'known'). Information, in this context, is the raw data on which knowledge is constructed. Moreover, information itself can only be meaningful through some form of communication among people because information only contributes to knowledge when it is processed using mostly learned ways of interpreting the world. Information therefore never stands alone: it always *represents* something. According to economist and communication theorist Robert E. Babe,

Information ... is inevitably in reference to something else. Light waves reflected from

an object and perceived by a viewer transmit the surface characteristics of the object, but the light waves do not constitute the object. Likewise, the word 'chair' signifies an object or a class of objects but is not itself that object or class of objects.

(1995: 12)

Information also is immaterial. Again, it is only through the brain's processing capabilities that information becomes meaningful and this is important because it directs us to question what is an implicit and common assumption in much academic and popular thinking about the information society/economy. Given its inherent characteristics, definitions and studies that focus on qualitative aspects of information society/economy developments, such as those discussed above, stand on shaky ground indeed. A snappy advertising slogan or a precise scientific formula can affect millions of lives far more profoundly than even the most comprehensive database. The meaning of information, how it shapes what is known, and its complex implications are comprehensible only through the development of qualitative analytical tools that take into account both the mediating effects of the communication process and the interpretative abilities of people.

The information society/economy and IPE

What then is an information society and an information economy? If the efforts of Machlup and Porat, for example, only constitute quantitative indicators that *something* is changing, how can we understand these developments in terms of their qualitative attributes? If political-economic activities have always involved information and knowledge, in what ways have things *really* changed and in what ways are they likely to affect the international political economy?

The relative importance of qualitative factors in issues concerning information should serve to encourage students of IPE to focus on questions involving knowledge when assessing information society/economy developments.

Political economist SUSAN STRANGE, for one, can be credited with bringing knowledge into the mainstream of critical IPE. In her book *States and Markets*, Strange outlines the role of the international 'knowledge structure' as a component of what she calls 'structural power'. The latter is defined as:

the power to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises.

(1988: 25)

Power, in relation to the knowledge structure, involves the ability to both deny and convey what is known. Having said this, however, Strange does not provide a precise theorization of how information is related to knowledge. One reason for this absence is her collapsing of information with knowledge and the absence of a conceptualization of their relationship.

Another IPE scholar who has addressed the issue of knowledge is ROBERT COX. Through his historical materialist approach, Cox has developed an analytical category called 'ideas'. Ideas, for Cox, entail shared practices and meanings as well as differing perspectives. Under this category, diplomatic conduct, economic theory and even gender roles are included in his analysis of the world order and these are dialectically related to developments involving two other categories – 'material capabilities' and 'institutions' (Cox, 1987). Despite its sophistication, the category of ideas, as with Strange's knowledge structure, lacks a necessary theorization of the capacity to process information *into* knowledge, both for individuals and collectivities. How, precisely, ideas are related to material capabilities and institutions is important to work out if one hopes to understand how ideas – such as the desirability of consumerism or the naturalness of a competitive marketplace – are constructed, modified or dissolved.

Perhaps one of the most daunting conceptual hurdles facing students of IPE in relation to information society/economy issues is the sociological complexity of the subject. In order to understand the process in which information is

related to knowledge, and thus develop a full understanding of the potentials and implications of information-based developments in the international political economy, an approach that relates macro- with micro-levels of analysis is required. Given the nature of information and the central role played by people in giving information meaning, IPE scholars will be required to go beyond the global, the national or even the local. To fully comprehend the processes and implications of information society/economy developments, the mass media, the internet, the household, the school, the shopping centre, the village marketplace and many other nodal points that directly shape the intellectual capacities of individuals will become increasingly important subjects for analyses. As sociologist Frank Webster explains,

We exist in a media-saturated environment, which means that life is quintessentially about symbolization, about exchanging and receiving – or trying to exchange and resisting reception – of messages about ourselves and others. It is in acknowledgement of this explosion of signification that many writers conceive of our having entered an ‘information society’. They rarely attempt to gauge this development in quantitative terms, but rather start from the ‘obviousness’ of our living in a sea of signs. one fuller than at any earlier epoch.

(1995: 22)

In a sea of information, what is becoming increasingly important is the capacity to process information, how that processing takes place and who has the power to shape processing capabilities. Power in a world that is saturated with information increasingly will lie in the hands of states, corporations, organizations and individuals possessing the ability to not only produce and disseminate information but, more fundamentally, with those who can influence how others interpret it.

For students of IPE, it is important to historicize information society and information economy developments. These have neither been necessarily rational or inevitable. Instead,

they reflect the interests and powers of some states, corporations, organizations and individuals over others – most particularly involving the power to shape *what is known*. If, however, contemporary conceptualizations of the information society/economy, despite their shortcomings, draw attention to the relationships between quantitative and qualitative indices of world order, their value as heuristic tools is potentially high. In the best tradition of neo-Gramscian political economy (see NEO-GRAMSCIANISM), for example, the existence of an information society/economy – at least in relatively developed parts of the world – has become a common-sense fact of life. It is precisely for this reason that both terms and their technological and economic definitions should be subjected to critical scrutiny. Nevertheless, something indeed has changed and is changing in the international political economy. It is through the development of relatively qualitative analytical capabilities that the forces and processes at play and their implications can be fully appreciated.

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EDWARD A. COMOR

infrastructure

Infrastructure comprises the stock of non-military physical and social capital owned by the public sector. This 'social overhead capital', a synonym for infrastructure, can be grouped into four categories: utilities (water, electricity and natural gas supplies; waste collection and disposal), communication (telephone, postal and cable services), transport (roads, railways, airports, shipping canals and ports) and land development (drainage improvement, flood control, irrigation and reforestation projects). These categories produce services that directly enter the private production process as intermediate inputs. Without their existence, a private production of goods and services is hardly possible or is possible at a lower efficiency only. Another category is social capital. It is investment in such services as public health and education (hospitals, recreation facilities, schools). These services are mainly produced for private consumers. But they enter the production process indirectly as the human capital of the labour force.

Public infrastructure provides services for more than one firm or household. Most of their services are not pure PUBLIC GOODS because individuals can be excluded from consuming the specific service. Therefore private provision of these services is, in principle, possible. However, supplying these services very often

requires tremendous initial investment and once the specific facilities are constructed, servicing an extra consumer is usually possible at small extra cost. With high fixed- and declining average-costs, and with the difficulties of pricing and capturing its pecuniary reward, infrastructure does not conform to normal market-investment analysis. Thus it is generally maintained that the government has to provide these goods and services either free of charge (as in the case of roads) or at prices that cannot be identified as market prices.

Competitiveness of enterprises in international markets is determined, in part, by the costs of inputs and by the services of infrastructure. Its provision contributes to total factor productivity and is an important complement to private investment activities.

The monetary benefits that private industry gains from the provision of social capital can be examined by calculating the cost savings associated with using public services. Numerous studies conclude that there are considerable productivity advantages associated with public infrastructure. Information on the contribution of infrastructure to productivity is necessary to support and direct the allocation of public investment expenditures in the process of restructuring both developed and less developed countries. As higher taxes are required to make up the revenue shortfall from subsidizing industries by costless infrastructure services, it is not obvious that the benefits always offset the negative effect of higher taxation. But the creation of infrastructure promotes growth and attracts new firms, and corresponding higher tax revenues can, in the long-run, finance the subsidy. Since many governments seek to minimize the role of the state, privatization of public services is an important topic in infrastructure policy (privatization of railways and of telecommunications or postal services, for example).

See also:

development of underdevelopment; least-developed countries (LLDCs)

KLAUS CONRAD

Innis, Harold Adams (1894–1952)

Harold Innis is Canada's most celebrated political economist. A long-time member of the Department of Political Economy at the University of Toronto, he was also a public intellectual, deeply engaged with the political and moral issues of his time and place. Pursuing both theoretical speculation and detailed (if not always meticulous) historical research, Innis produced two distinct bodies of scholarly work: the staples model that interpreted the history of Canada in terms of its export of primary goods (staples); and a theory of communications that explained the character and success of empires in terms of their principal mediums of communication.

To understand both phases of Innis's work, it is necessary to set them against the circumstances of his life – that of a colonial intellectual. Growing up on a small southern Ontario farm, Innis intended to become a Baptist minister, and to that end he entered McMaster University in 1912. Completing his studies in 1916, but also driven by fierce patriotic beliefs, he postponed entering the church to enlist in the Canadian infantry and fight in World War I. It was a pivotal decision: 'he went to war as a Christian and a colonial ... [but] came back an agnostic and a Canadian' (Watson 1981: 24). In particular, the horrific experience of trench warfare (especially at the battle of Vimy Ridge where he was severely wounded) convinced Innis that, first, there was no beneficent caring God and, second, given the callousness and stupidity of the British High Command to which Canadian troops were subject, there was no beneficent caring empire of King and country either. His conversion to a secular nationalism, made on the battlefields of France, infused his life's work.

That work began immediately on Innis's return to Canada in 1917. Still recuperating from his wounds, Innis completed an M.A. at McMaster University and then, in 1918, entered the University of Chicago to study for a Ph.D. in economics. Although THORSTEIN

VEBLEN, the American institutional economist, had long left the Chicago economics department, his intellectual legacy remained potent. Certainly, Innis's own brand of secular nationalist economics was later to draw heavily on that legacy. The completion of his doctoral thesis at Chicago on the history of the Canadian Pacific Railway led in 1920 to his appointment at the University of Toronto.

Innis's more than thirty-year career at Toronto can be divided roughly into two periods. In the first he developed the staples thesis. The key idea is that shaping Canadian history since European colonization has been the export of a series of minimally processed raw materials to other, more industrialized countries. For Innis, staple industries are central because they are the leading sector of the economy, setting the pace for overall economic growth. Growth, however, because of the very nature of staples commodities is continually frustrated and never comes to fruition in the form of equilibrium development. Because of such factors as volatile primary commodity markets, foreign corporate dominance of the resource sector and an ingrained export mentality, staples economies are ensnared in what Innis called a 'staples trap': a situation in which industrial diversification is thwarted. The result, again to use Innis's terminology, is that staples-producing regions become 'hinterland' economies, the fates of which are strongly tied to events in other more powerful countries.

Of course, this is not the conclusion of standard economic theory which would claim that staples nations, such as Canada, through the free workings of the market would eventually achieve equilibrium development by specializing and trading in those commodities in which they possess a comparative advantage, namely, primary resources. Innis (1956: 3), however, dubbed this view 'a new form of exploitation with dangerous consequences'.

To avoid such consequences, Innis developed his staples theory in such a way as to be peculiarly suited to the local Canadian context. That theory brought together three concerns:

- 1 The geographical, which refers both to the natural resources of an area and to specific patterns of spatial interaction. For example, the flows of goods between resource sites and global markets.
- 2 The institutional, which includes political bodies and their forms of regulation, as well as the institutional character of business. With respect to the latter, Innis thought that the dominant players would be corporate and foreign-owned because of the large sums of capital investment required for resource exploitation.
- 3 The technological, which determines what counts as a resource, how it is exploited and, through transportation technology, the geographical relation between the resource-producing area and downstream activities.

For Innis, when the right geography comes together with the right institutional structure and the right technology, the result is growth of 'cyclonic' frenzy. In this way, virgin resource regions are transformed and enveloped within the produced spaces of the capitalist periphery. Such intense accumulation never lasts, however, and because of the very instabilities of staples production, sooner rather than later investment shifts to other places, leaving in its wake abandoned resource sites and communities.

At some point during the late 1930s, Innis abandoned his hitherto successful work on staples and began following a different line of enquiry: communications. A likely catalyst was Innis's planned study of the pulp and paper sector. Originally an investigation of yet another staples industry, because of its linkages to print media it prompted Innis to think broadly about communications.

Innis's (1951: 33) main thesis is that the 'medium of communication has an important influence on the dissemination of knowledge over space and time ...'. By 'medium of communication' is meant the form in which knowledge and information are transmitted: is it transmitted by stone tablets or by e-mail? For Innis, the medium of communication is vital because it determines what is communicated

and hence the social activities that can be carried out. Specifically, Innis argues that those who control the medium of communication possess power and authority, because they are able both to define what counts as knowledge and to control how it is used. The medium of communication is not simply a neutral carrier of the message, then, but deeply complicit in a wider system of politics and power.

To illustrate his thesis, Innis undertook a series of historical studies of different empires, correlating the dominant medium of communication with dominant political and social characteristics. He recognized two main types. 'Light' communication (such as papyrus, paper and, later, electronic media), because of their ease of transmission across large distances, are associated with the centralized institutions of empire, such as the state, the military and, in the twentieth century, the multinational corporation. Specifically, light media are 'biased' towards space in that they allow for the creation of spatially expansive empires. This is because 'improvements in communications strengthen distant centers of authority and shift control to higher echelons of organization' (Carey, 1975: 33). In contrast, 'hard' media, (stone or clay tablets, for example) are much more difficult to transport and lead to spatially confined 'monopolies of knowledge', to use Innis's term. Because of the very nature of the medium, social relations are defined by a single, local source of power, originating from historical and religious authority.

Because of his relatively early death, Innis never completed his communication studies. By that point, however, he was already a powerful and influential figure, not only in Canada but also internationally. (He was elected President of the American Economics Association in 1950.) In addition, his communications work had already influenced Marshall McLuhan and his staples model was the basis of a new school of Canadian political economy. By the 1970s, however, Innis's reputation faltered. The reasons are not hard to find. There was the perennial problem of *how* he wrote – 'cryptic', 'enigmatic' and 'dense' are some of the gentler euphemisms applied to his prose. But there was

also a problem in what he wrote *about*. The staples model, for example, seemed less and less relevant to a contemporary Canadian economy based now upon services. In addition, social theorists of a variety of stripes took issue with Innis's assumptions: he was a naive technological determinist; he ignored the role of women and aboriginals; he made market relations of exchange dominant at the expense of production and social class, and he portrayed Canada as a helpless victim, even though it remained one of the world's wealthiest nations. Many of these points are telling. But Innis was always a restless analyst, excising, amending and rewriting to deal with the changing problem at hand. While the details of Innis's theories may no longer be credible, his restless sensibility remains indispensable.

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TREVOR J. BARNES

institutional investors

Institutional investors are financial institutions which manage savings collectively on behalf of individual investors, towards a specific goal in

terms of RISK, return-maximization and maturity of claims. The common features of institutional investors are found primarily on the asset side of their operations. Their first common feature is that of risk pooling. By facilitating greater diversification than an individual could attain through the direct holding of securities, institutional investors spread the risk of investing to a number of individuals liable to similar uncertainties. In addition to risk pooling, institutional investors are also characterized by professional management based on a fiduciary relationship to the ultimate investor. A fiduciary relationship is generally one in which the manager endeavours to minimize risk, maximize returns and preserve capital on behalf of the individual investor. Professional management also implies greater resources in terms of expertise and the collection and analysis of relevant investment information. A final characteristic, common to all institutional investors, is size and the benefits which result from ECONOMIES OF SCALE, such as the ability to pay lower brokerage fees due to a higher volume of transactions. Institutional investors include, for the most part, MUTUAL FUNDS, HEDGE FUNDS, pension funds and life insurance companies whose differences relate primarily to the liabilities side of their operations – that is, the nature of their relationship to those who invest with them.

See also:

financial institutions; portfolio investment

ADAM HARMES

institutionalism

Institutionalism is an analytic approach common to several of the social sciences. In economics, institutionalism developed originally in the United States in the late nineteenth and early twentieth centuries in opposition to both neo-classical and Marxist thought (see MARXISM–LENINISM; NEO-CLASSICAL ECONOMICS). More

recently, a ‘new institutional economics’ (NIE) that is quite different from the ‘original (or old) institutional economics’ (OIE) has been built on a neo-classical foundation. This entry will deal primarily with the method and theory of OIE and commonalities of this approach across the social sciences, contrast OIE and NIE, and then discuss OIE’s role in international political economy (IPE).

Method and theory of OIE

As the term ‘institutionalism’ suggests, the most basic tenet of OIE is that ‘institutions’ should be the basic unit of analysis. Institutions are patterns of thought and behaviour common among a group of people, perhaps those of a nation or other geographic region. Institutional economics involves the analysis of patterns having to do with provisioning: that is, with the provision of material means for all the activities of a group. For OIE, provisioning is understood broadly to include the activities involved within households as well as the commercial activities of firms and the activities of governments.

The goal of OIE is to discern patterns of behaviour and to do so with a minimum of preconceived ideas. For the founders of OIE, THORSTEIN VEBLEN and John R. Commons, this meant reliance on historical analysis of prior patterns and observation of their own era. Both used histories of legal systems, of business enterprise and, in Veblen’s case, a largely hypothetical prehistory that was widely accepted among anthropologists in the late nineteenth century. Wesley C. Mitchell added descriptive statistics to the institutionalists’ tools.

Historical, narrative and statistical analyses have led, over the course of the development of institutionalist thought, to five general theoretical propositions that remain the analytical core of OIE. The first is that the institutions that organize provisioning (and other human activity) are largely the consequence of complex, socially inherited patterns. Economic behaviour is culturally patterned and varies as local histories and cultures vary. Individuals are enculturated (imbued with the patterns and

understandings of those around them) from birth and their patterns of behaviour, their tastes and their preferences are products of that culture. 'Culture' itself is the whole of the institutional patterns shared by a people. Even though cultures overlap in the modern world – where people, goods and ideas move rapidly from place to place – the idea of discrete cultures remains an important tool in institutionalist political economy.

The second point of OIE theory is that institutional (cultural) changes are evolutionary, cumulative and interrelated. Veblen used the phrase 'cumulative causation' to describe the process of socioeconomic change. This means that change in one part of a socioeconomic system leads to change in other parts, and it is for this reason that OIE is sometimes described as holistic (see HOLISM). Non-holistic analysis that focuses on a pre-determined range of activity is in danger of excluding parts of socioeconomic change that may be critical for full understanding. The process of change is also cumulative. Previous patterns of thought and action shape present change, and present change shapes future responses to the new.

Modern MULTINATIONAL CORPORATIONS (MNCs) illustrate well the process of cumulative and evolutionary change. Veblen, in his *The Theory of Business Enterprise* (1904), and Commons, in *Legal Foundations of Capitalism* (1924), both described how concepts of ownership and property that had evolved over centuries in Western Europe were cumulatively modified to accommodate individual and alienable ownership of land, and (after the INDUSTRIAL REVOLUTION) to accommodate a shift from ownership of craft-produced tools and goods to ownership of large-scale industrial capacity. More recently, these concepts have evolved to incorporate ownership of rights to expected future income streams that are separated from possession of any actual physical assets. Changes in the processes of production from craft to industry produced changes in ways of thinking about business enterprise and in the laws governing such

endeavours. There followed changes in methods of finance and in the laws governing the new forms, and greatly increased numbers of stocks and bonds issued by firms.

By early in this century, a new form of business enterprise had emerged: the modern, professionally managed, industrial corporation, standing as an individual in the law and with its ownership diffused. However, important elements of old ways of thinking and understanding continued so that 'owners' (shareholders) were assumed to have rights to income from sale of output that were the same as the rights of the craftsmen of an earlier era. Craftsmen combined their labour with their tools to earn their incomes. Shareholders are now said, in the capitalist economies of the twentieth century, to earn their dividends because their 'CAPITAL' gives them rights to their incomes. What is important for OIE theory is that the justifications for who has power in the organization of production and for the distribution of shares of output that seem 'natural' to most Westerners, emerged from a particular and by no means universal history. These justifications in law and in social and economic theory are themselves part of the evolution of the modern firm.

Ongoing changes in communications, transportation, law and other aspects of cultures have now led, via the same cumulative and evolutionary process, to multinational corporations. Though there have been many similarities in the processes in the various industrialized nations, the specifics of LAW, REGULATION, finance and public attitudes have varied as consequences of different national histories. To cite a well-known contrast, in the US antitrust laws were passed late in the nineteenth century in an effort to limit coordination among firms while, conversely, Germany encouraged the formation of CARTELS as being in the public interest. Reverberations from this divergence continue in public policies and in legal and financial structures 100 years later.

The third tenet of institutionalist theory addresses the sources of evolutionary change.

In 'Why is economics not an evolutionary science?' (1898), Veblen noted that it was not sufficient for an evolutionary science to offer a narrative survey of successive developments: what was required was an explanation of *how* change takes place. Veblen argued that a basic and universal human propensity to what he called 'idle curiosity' leads to changes in the ways in which humans interact with their environments. The changes in technology that result from manipulation of nature lead to changes in perceptions of the world and, in turn, to institutional change which has further cumulative effects. For Veblen, purposeful actions are largely repetitive and based on prior knowledge. Change comes from the propensity of humans to do routine things in different ways and from the spread of the new ways of doing things. For Veblen, it is curiosity in manipulation of existing tools and ideas that initiates change. New 'common-place generalizations' about the world – water runs down hill, running water can be used to move such things such as wheels – develop as people work with tools, and these common-place generalizations may then inhibit further novelty of thought. Yet the propensity to curiosity and manipulation ensures ongoing change which, even when the consequences are dramatic, is always incremental in that it is based upon recombination of existing tools and ideas. Such technological change is, in OIE, the source of evolutionary change.

Clarence Ayres, a leading institutionalist theorist of the middle of the twentieth century, added to Veblen's argument, stressing that the cumulative process of learning that Veblen described gives mastery over the physical world (though not always with happy consequences, as modern environmentalists are right to argue) and that this mastery was cumulative and cross-culturally transmissible. Though much of inherited learning is culturally specific, there are elements that can be shared among people who speak different languages, believe in different deities and have very different sets of values. Because such things as antibiotics, aeroplanes and cars can be easily imported into otherwise diverse cultures, the process of

socioeconomic change has been accelerated in the twentieth century. Rapid TECHNOLOGICAL CHANGE through the nineteenth century spread internationally as other groups were brought into the process. Many of the changes were consequences of adaptation of what had been developed elsewhere, but at the same time a larger number of people also vary the ways in which they use new technology, and that speeds further change.

The fourth basic element in OIE theory has to do with value and valuing. Economists, at least from Smith onward, have made a theory of value central to their deliberations, first by searching for the common source of value whose varying ratio in products could explain relative prices. For the classical and Marxian economists, this common source was labour. For later neo-classical economists, value derives from individual tastes and preferences that are beyond the range of economic analysis and from costs of production. In contrast, OIE treats values as part of a process of valuing and treats that process as part of the same using and learning process to which Veblen attributed evolutionary change. Valuing is a social process in which people learn to value that which is valued in the culture into which they are born, and then learn, through use, to value the new and to change expectations in fundamental ways. The process whereby products – air travel, computers, cars and *Coca-Cola* – have spread throughout the world is one in which new technologies led not only to 'greater value' by satisfaction of wants, but also to want-creation through a social process of valuing the new. OIE theory is dynamic in that wants, opportunities and constraints evolve cumulatively through social processes. Value is, in other words, socially constructed. It is the process of valuing rather than value that should be the focus of analysis.

The fifth basic element of OIE theory involves conflict and its resolution. The processes of socioeconomic change put groups in conflict with each other over who will do what in the processes of production and distribution, who will get what shares, and how social and political power will be affected. JOSEPH

SCHUMPETER's description of economic development as a process of 'creative destruction' is apt because it stresses the destructive side of change. It is the destruction of old rules of work, of old claims to shares of output and of old privilege that makes conflict an inevitable part of economic change and growth. OIE shares the emphasis placed by KARL MARX and other classical economists on conflict within economic systems and on group interests within that conflict. However, OIE analysts follow in the path of Commons and stress that the groups in conflict change in composition because of the evolutionary process. In industrial economies in the twentieth century, conflicts have not been so much between the 'capitalists' and the 'workers' of Marx's mid-nineteenth-century world as between professional managers, other salaried employees, wage-earners, shareholders, lenders, consumers, government agencies and public interest groups such as environmentalists and public health organizations. Commons stressed the role of courts and the law in adjudicating conflicts and also analysed dispute resolution involved within firms and as part of political processes. For OIE analysts, conflict and its resolution is not only consequence but also cause of further evolutionary changes. As interests are redefined, new 'rights' and claims created, and those rights and claims contested. During the twentieth century, the 'rights' of consumers have emerged and been redefined by courts and regulatory agencies who set standards. In turn, the extent of the 'rights' of producing firms (and their shareholders) and of landowners have been reduced. These groups have, in consequence, made new claims to 'rights' – as in the United States where courts have been entreated to rule against 'takings' of property through environmental standards. Conflict is as ongoing as the cumulative process of evolutionary economic change and is, inevitably, bound up in that change.

The meaning and importance of the five tenets of institutionalist theory are put in sharp relief when compared to two other major approaches in economics. The dominant neo-

classical approach (see NEO-CLASSICAL ECONOMICS) adopts the individual as the basic analytical unit and puts 'tastes and preferences' largely beyond the explanatory reach of economic analysis. Business firms, legal systems, governments and, in some of the more extreme modern applications, even families are described as products of individuals who contract with one another to achieve the best results for themselves, given their already existing tastes and preferences, and their initial positions – their resource endowments. The process of evaluation and decision-making involved in this ubiquitous contracting is assumed to be a universal process of rationality.

Institutionalists share more with Marxian economists than they do with neo-classicists, though there are profound differences as well. Marx and the other classical economists did incorporate history and culture into their analyses as they wrote about the changing social classes of late eighteenth- and nineteenth-century England. However, Marxian analysis has continued to stress conflict conceived in mid-nineteenth-century terms. The core conflict that is still central to Marxian theory is that between capitalists (owners, not managers) and workers over the distribution of profits (not professional salaries, professional benefits and other modern distribution shares). A further and perhaps even more fundamental difference between OIE and many Marxian analyses derives from their adherence to Marx's classical assumption that there is an inherent value. The ideas of EXPLOITATION and of SURPLUS VALUE rest on the proposition that there is a departure from a naturally equitable distribution in which labour would receive the full value of its input. Most institutionalists share the view of Marxians that sharply skewed income distributions are undesirable, but regard shares of output as always socially determined, just as the values placed on inputs are socially determined. There is, in the OIE view, simply no culturally independent measure of the 'full value' of labour or any other input.

A final and important contrast between OIEs and both neo-classicists and Marxians is in their emphasis on evolutionary rather than

revolutionary reform. Institutional economists from early in the twentieth century have emphasized non-utopian reform. Given the view of the economic system as an always evolving set of inherited patterns, it follows that human intelligence can be brought to bear on making the system more effective and equitable. Commons and his students designed a number of basic reforms in the US economy in the 1930s – most notably the Social Security System – and did so on the understanding that, because change is evolutionary, new systems are always built on what already exists and on the ways in which what exists is understood by participants. These reformers also designed new systems without the neo-classical concerns that redistribution would cause the economy to move away from a natural equilibrium or from a one-best-path of economic growth. Economic growth is conceived as a consequence of technological change, with the distribution of increased output a socially determined matter.

The emphasis on reform makes it clear that OIE analysis does not assume that individuals are simple puppets of either their culture or of inexorable forces of history. OIE treats individuals as active, thinking beings, always guided by inherited ways of thinking and evaluating, but also capable of change. These beings can remake their societies and are thus accorded much greater power in OIE analysis than in either Marxian analysis (through which individuals are analysed as part of historical forces) or in neo-classical analysis (by which they adjust to exogenous change by a universally given logic).

The emphasis on reform in institutional economics does raise an important question about the role of economists in such change. The economist as envisioned in neo-classical analysis is a 'scientist' whose only legitimate 'scientific' interest is in discovering and explaining what is. Actually, of course, the neo-classical assumption – that initial resource-endowments are in some sense just – means that the question of what is just is never really considered. The advice given by neo-classical economists is thus couched as advice about how to restore the natural and efficient work-

ings of economies, rather than in terms of socially chosen reform. Even in Central and Eastern Europe, where neo-classical economists have been especially active in giving advice, the advice is alleged to be 'neutral' and 'scientific' on the grounds that it is advice to return to the 'natural' (and therefore optimum) form of economic organization – the 'free-market economy'.

If, however, socially chosen reform is legitimate and proper, what role should the institutionalist play in the process? From the view that there is no 'natural' and universally just organization of production or distribution of output, it follows that the institutionalist does not have a template of perfection against which to hold real economies. Instead, OIE economists can only play the role of informed participants in a democratic process. This is a view of reform that rests fundamentally on the view that all voices should be heard and reforms adopted through procedurally open processes. There is no hope that any reform will satisfy for long; change is ongoing with no final end and the process of broad participation will not eliminate conflicts. Instead, as Commons put it, adherence to such a process will ensure a *reasonable* outcome.

Institutionalism and other social sciences

The roots of OIE are those that also gave rise to several of the modern social sciences (most notably sociology and anthropology) and to political science in the 1930s and 1940s. The concept of culture was the foundation for these disciplines and for OIE. It was this concept that unified much of social science between 1900 and 1950. In the years since World War II, in an era of individual mobility and of increased political equality among nations, greater emphasis has been given to universal rationality than to cultural diversity. This trend led to wide interest in the neo-classical model of RATIONAL CHOICE and to the disciplinary imperialism of many neo-classical economists who, as noted above, broadened claimed areas of explanatory power to include the family, the law and the organization of governance, as well

as of markets. The appeal of neo-classical models was made greater by concern among anthropologists and sociologists that earlier work in their disciplines had ignored individual decision-making and action. Particularly in an era when individuals have been able to move from one country to another and, in the process of doing so, to change cultures, it seemed that earlier scholars had overemphasized cultural determination. Social scientists wanted to emphasize self-centred action and, with its apparent emphasis on individuals and self-interest, neo-classical economics was attractive.

However, the spread of neo-classical economics did not displace the core concept of culture in anthropology or sociology, or in some parts of political science. Because these disciplines had, in common with OIE, patterns of behaviour as basic units of analysis, the rational choice models constituted *additional* analysis of described patterns rather than a replacement for what these social scientists had always done. There is now a strong move in the various social sciences toward explicit recognition that models of rational choice cannot substitute for description and historical analysis, recognition that adequate models must incorporate both unthinking obedience to cultural norms *and* the strong opportunism of individuals. As this has always been the view of OIE, its approach is once again closely allied with sister social sciences. The story is different within economics.

Contrasts between OIE and NIE

Over the past twenty years, there have been a number of efforts to solve a basic limitation on neo-classical economics that has resulted from the assumption that all of the information, values and beliefs brought by individuals to their contracting is beyond the realm of economic analysis. The new institutionalism (NIE) has been an effort to make institutions 'endogenous'. What this means is that attempts by new institutional economists to offer explanations of institutions are built upon neo-classical analysis; the goal is to explain

institutions as products of the same rational choice process that is assumed to govern the purchase or sale of products and services. Institutions are all treated as products of choice. The development of NIE illustrates the broadening of the neo-classical explanatory domain noted above, even if it also represents an explicit recognition of the importance of institutions.

Unfortunately, however, neo-classical analysis is not amenable to the 'endogenization' of institutions, precisely because it assumes the existence of a supracultural mode of choice. If rational choice guides the development of all human institutions, what is the source of rational choice? Is it, as some sociobiologists would argue, part of human biology? If so, then why were the most 'efficient institutions' not chosen early in human history? How does one account for the enormous variation of institutions described in history and anthropology? To date these issues have not been satisfactorily resolved within NIE.

Significance of OIE for international political economy

In this final section, several observations about the relevance of OIE for international political economy are offered. Critical to IPE is the need to account for diversity and for INTERDEPENDENCE. In OIE, the economies of nation-states, and of both smaller and larger geographic regions, are consequences of a general process of what economic historians call 'path dependence'. The process of cumulative and evolutionary change means that quite reasonable and rational people with different histories will respond differently to the same situation. In discussions of the international economy, neo-classical economists often invoke 'culture' as an exogenous factor, but do not incorporate the concept into their theory. In OIE, the history that leads to differences is central to the analysis of the international economy.

For many, this emphasis on the importance of the histories of different places seems excessively particularistic and descriptive, even untheoretical. Without a way of dealing with

interdependence and common themes across countries, it would be. For OIE, common patterns emerge from common biological characteristics of humans, the most important being curiosity and the proclivity to learn (through speech and through manual and mental dexterity) and to adopt technologies from other groups. In this view, what has given rise to modern IPE is a technological intertwining of the world that can be traced back to improved sailing ships, navigation, printing and beyond, but which has rapidly accelerated with steamships, railways, cars, planes, the telegraph, telephones, radio, TV and, of course, computers and related developments.

The development of these ways of moving people, goods, words and symbols has produced the organizational challenges that constitute the substance of IPE. In OIE analysis, the ways in which people think about these challenges, the conflicts they entail and the possible ways of reasonable resolution are part of the same evolutionary processes that have produced the new technologies. Several illustrations may be offered.

One of the earliest issues that arose in modern IPE was the debate over FREE TRADE. The debate had originally to do with tariff protection of producers of grain in Britain and was set in a context of war, industrialization and urbanization. The Smithian and Ricardian arguments about specialization and comparative advantage that were offered in debate among contesting groups in England became part of the intellectual heritage of the Western and now the entire world. When rapidly falling TRANSPORT COSTS, the opening of new and very rich agricultural regions of the world, and rapid industrialization produced substantial economic growth in the late nineteenth century, the free traders seemed vindicated. 'Free trade', meaning an absence of tariff protection, was seen as a major cause of the great increase in economic well-being and many continue to regard it as such in the present. In the last half of the twentieth century, however, when much of the movement of goods is organized within multinational firms and when comparative advantage is much more clearly man-made

than nature-given, the terms of the free-trade debate of the nineteenth century seem less relevant. As nations and groups within nations are in conflict with each other over who will produce steel or cars or shoes, and at what rates of exchange, the free-trade argument remains a powerful political argument.

Closely allied to the arguments about free trade are arguments about 'capital' mobility. Here too the legacies of particular histories are very important. As noted, in the Western industrial countries (and particularly in Britain, where so much of modern economic thought originally developed) part of the justificatory system for who got which shares of output involved the equation of money (what shareholders contribute to a firm) to tools (what craftsmen brought to the enterprise). As financial markets developed in the nineteenth and twentieth centuries, part of the cultural understanding was that investment of money was a crucial element in economic growth and in the growth of individual enterprises. There is truth to this view in any system in which money commands resources, but there is also an element of myth: money by itself does not produce productive technology and most often follows, rather than initiates, the start of successful endeavours. Nevertheless, the idea that money initiates economic growth has been a powerful idea, as has the idea that foreign investment is critical to economic development. The historical record says otherwise.

Countries that have enjoyed the highest rates of growth have generally done so without foreign investment of funds, but Western belief outweighs historical evidence. Once again, the history of a particular nation and the history of its conflicts in the process of economic growth shape political debate. That foreign money has never been sufficient to produce development can be explained using the distinction drawn between PORTFOLIO INVESTMENT and FOREIGN DIRECT INVESTMENT (FDI). Portfolio investment (which is to say, purchase of shares in existing enterprises) may have financial consequences, but is not usually thought to be a source of economic development in poorer

countries. On the other hand, direct foreign investment that involves building factories in a relatively poor country *may* produce development, but it has often produced ENCLAVES that have had little or no effect on the economy in which they are physically located. They are part of an international economy, without being part of the domestic economy as a whole. Whatever the actual effects, however, the argument is often couched simply as a matter of mobility of capital, with that mobility seen as key to further development. The advice of the INTERNATIONAL MONETARY FUND (IMF) and of other agencies that rely heavily on neo-classical economics makes sense if you accept the equation of money and tools that was a crucial part of English-dominated nineteenth-century thought, but there seems no more reason to accept this than there is to accept that witches are a lively threat to the peace of the community. From the OIE perspective, the IMF advice makes little sense because the objective of development should be to devise policies that enhance the adoption, creation and development of new technologies. Such policies probably have little or nothing to do with 'capital' mobility.

A similar issue arises in the case of the familiar argument that, even though ultimately the fruits of economic development should be widely shared by a population, inequality of income is desirable now because it will produce growth in the future. Again, the OIE analyst would say that, in a commercial economy where raw materials, human effort and other resources can be purchased, money may be a necessary but not a sufficient cause; indeed, sufficient causes of growth may be stifled by an excessively skewed income distribution. This is because growth depends on learning that builds on the fruits of idle curiosity and purposeful adaptation of the new; these, in turn, depend on widespread participation of large parts of the population in industrial processes, be they on a farm or in a factory. In the view of most OIE economists, greater equality is more likely to increase rates of growth than is greater inequality.

Views of the international economy of the twentieth century other than those of OIE have

developed from other aspects of eighteenth- and nineteenth-century Western thought. In particular, those who have been troubled (as institutional economists have been) by the continuing great discrepancy between incomes within nations and between the rich and poor countries, have used distribution arguments that emerged from classical economics to develop twentieth-century theories. In particular, WORLD-SYSTEMS THEORY and DEPENDENCY THEORY rest on the proposition that an unfair share of total output has been diverted to the rich and away from the poor. In these theories, 'unfair' and 'fair' are given more than emotional connotation: they are given the colour of 'scientific' validity by their grounding in the ideas of a just distribution developed by the classical economists and elaborated by Marx. The appeal of these theories is that they offer systematic treatment of a real issue; the problem for OIE analysts is that they do not rest upon any actual 'scientific' evidence, but upon the perceptions of fairness of one time and one place, namely England between the mid-eighteenth and early twentieth centuries. These roots of world-systems and dependency theory limit the range of proposals for reform to greater equity in sharing and do not, from the OIE perspective, address the real issues of creating systems that engender growth and equity within nations.

OIE theory suggests that clearer understanding of the conflicts, the issues and the possibilities in late twentieth-century IPE would be achieved if the legacies of earlier times and places were recognized as legacies rather than universal truths, and if conflicts among groups and ongoing disputes that arise because economic change involves new ways of producing and distributing were recognized as inevitable. Reasoned reform is the OIE answer to the problems of IPE.

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ANNE MAYHEW

institutionalism, liberal

'Liberal institutionalism' is a school of thought within the study of international politics which contends that international institutions – for example, the UNITED NATIONS (UN), the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), the INTERNATIONAL MONETARY FUND (IMF) – help facilitate cooperation between countries. Liberal institutionalism is 'liberal' because it regards life in the state of anarchy to be less 'nasty, brutish and short' (to quote HOBBS) than realists do. It is institutionalist because it explicitly claims that international institutions foster international cooperation. In this way, liberal institutionalism is different from what David Baldwin (1993: 4) has called 'commercial liberalism' which argues that international trade fosters

peace, 'republican liberalism' which claims that democratization leads to peace and 'sociological liberalism' in which transnational interactions promote peace.

Liberal institutionalism can be traced back to a 1795 essay by IMMANUEL KANT, 'Perpetual peace', which argued that a federation of liberal democracies should be created which would guarantee the rights of its member-states. Woodrow Wilson put liberal institutionalist thought into practice by insisting on a provision for a collective security organization, the League of Nations, in the Versailles Treaty that ended World War I.

Perhaps the best example of modern scholarly liberal institutionalist thought (sometimes called 'neo-liberal institutionalism') is *After Hegemony* (1984) by ROBERT KEOHANE. Relying heavily on insights from industrial organization theory (notably the Coase theorem), Keohane argued that international institutions helped countries solve problems of EXTERNALITIES in their policies by reducing the costs of cooperative transactions and curing information asymmetries. Keohane argued that the norms and negotiating procedures developed around international institutions reduced the costs of negotiating international agreements. International institutions can provide independent sources of information which can reduce the likelihood that countries will be taken advantage of by a deceptive negotiating partner, thus making countries less fearful of signing cooperative agreements. The rules and dispute-resolution mechanisms of international regimes provide independent sources of information about when countries have defected, so that innocent nations will not be mistakenly punished for transgressing the regime and regime violators can be found out and punished by the institution's members. (For a fuller discussion of these and other arguments concerning the role of international institutions, see REGIME THEORY.)

It should be emphasized that Keohane does *not* claim that international institutions have their own independent enforcement power. As such, they do not enforce cooperation on countries that do not want to cooperate.

Instead, they help countries that would like to cooperate but find it difficult to do so because of information asymmetries and high transactions costs. Ultimately, enforcement power still rests with the individual countries that are members of the institution.

Liberal institutionalism has been widely criticized by REALISM for its reliance on international institutions. Realists dubbed Wilson's liberal institutionalism 'idealism' and blamed it for World War II. International law was a chimera, they argued, and the makers of foreign policy would do best to ignore it, since states were never constrained by law but by power (see LAW, INTERNATIONAL). Carr's *The Twenty Years' Crisis* (1939) is an example of this type of argument.

Keohane and fellow liberal institutionalist scholars have also been criticized by realists, particularly neo-realists (see NEO-REALISM). Neo-realists claim that liberal institutionalists fail to recognize the *relative* nature of power. Today's cooperative partner may be tomorrow's enemy, they argue. If two countries do not gain equally from cooperation, the country which gained relatively more may use those gains against the relative loser in the future. Therefore, each country must attempt to gain more from any cooperative venture than the country with which it is cooperating. When two countries are contemplating a cooperative venture, each must ask itself not: 'Will I gain more from cooperation than non-cooperation?', but: 'Will I gain more than the country with which I am cooperating?' Since each country is attempting to maximize relative gain and since both countries cannot gain relative to each other at the same time, cooperation will be more difficult and rarer than liberal institutionalists let on, according to realists.

Little progress has been made reconciling the two schools of thought. Ultimately, whether cooperation is likely and whether international institutions help is an empirical question. Liberal institutionalists point to the remarkable degree of cooperation in trade policy under the auspices of GATT, in international finance through the IMF and in regional integration in the EUROPEAN UNION

(EU) (to name a few of the more prominent examples) as evidence for their contention.

Finally, it is important not to equate liberal institutionalists with world federalists – that is, the liberal institutionalists do not call for a WORLD STATE. On the contrary, Kant believed that nations should have the right to govern themselves as they see fit and that a world state would be global tyranny. He saw international law as a way for enlightened nations to defend their own and each other's autonomy, not do away with it. Not unlike Kant, Keohane sees international institutions not as some incipient world government but as tools sovereign nations use to improve their welfare by cooperative foreign policy.

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MICHAEL J. GILLIGAN

instrumentalism

Instrumentalism is Adolph Lowe's alternative methodological approach for economic theory and public policy. Rather than taking only the initial conditions as given and directing theory to predicting outcomes, Lowe proposed also

taking as given a vector of macro-economic goals. The task then becomes the derivation of the social and technical paths by which those outcomes might be achieved, of the behavioural and motivational patterns capable of setting the system onto a suitable path, of the environmental contexts capable of encouraging those patterns, and of the policies for creating those contexts. Economics is thus concerned not with the determination of macro-goals but with the means for their attainment.

Lowe was increasingly concerned with the inability of the nation-state to address the problems of contemporary political economy. In particular, he felt an effective authority to regulate MULTINATIONAL CORPORATIONS (MNCs) was needed. He also believed that the macro-economic challenge of achieving full employment would have to increasingly be addressed by supranational organizations such as the UNITED NATIONS (UN). Instrumentalism may provide a useful framework for devising and implementing economic policy in the age of GLOBALIZATION.

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MATHEW FORSTATER

insurance industries

Private insurance activities have grown during the last fifty years at a rate of 5 per cent per year in real terms the world over. The growth is due to the necessity of economically managing vulnerabilities linked to the mature phase of the INDUSTRIAL REVOLUTION. Such vulnerabilities concern the new technologies, industrial production, environmental issues and personal vulnerabilities (health, accidents, retirement and unemployment), as well as social vulnerabilities (from political instabilities up to the reorganization of the welfare state).

Although insurance companies are part of a larger group of financial services activities, they operate under specific principles, such as:

- the identification of specific classes of risk with an adequate level of homogeneity (taking into consideration the frequency of risks, their magnitudes and their variance)
- compensations are paid on the basis of mutuality
- the risk management of vulnerabilities must take into consideration such key issues as anti-selection (that is, buyers of insurance, knowing their vulnerabilities, may avoid informing their insurers about them) and MORAL HAZARD
- insurance can only operate within the limits of insurability: either the risks are of a very minute nature and they are simply costs of repairs or simple maintenance, or their level of uncertainty becomes so high as to be rationally unmanageable in this latter case, dealing with such large vulnerabilities can only be taken over by the state or by society at large

It must also be stressed that social insurance is very often a synonym not of insurance activities but of fiscal systems (where there is an element of transfer of resources among different classes or groups of people).

Some economists consider insurance activities as examples of 'MARKET FAILURES'. The failure is rather in the notion of a perfect market-equilibrium where all information is available. In fact, insurance industries have to deal with information which always lies in the future and therefore will never be available in a perfect equilibrium system. The future costs of any claim have to do with uncertainties, probabilities and finally risk management in a dynamic sense. The price determined in a contract at any given moment expresses a reasonable probability at best: costs will be known only after a period of utilization of any tool, system or service, incorporating then also the waste management, disposal and recycling costs. In this sense, utility is linked to performance in time and uncertainty becomes therefore a constituent part of the modern

integrated programme for commodities (IPC)

economic analysis, practice and theory. Day-to-day performance (where the value is) does not concern only insurance, but increasingly concerns economic activity in general. In fact, the costs incurred by the maintenance and functioning of all industrial products or systems during their operational life is higher today than the costs of the hardware used.

ORIO GIARINI

integrated programme for commodities (IPC)

The proposals for an integrated programme for commodities were announced at the fourth UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) conference at Nairobi in 1976, following the demands by less-developed countries in the UN General Assembly for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO). The proposals were made at a time when it was widely believed that the success of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) in raising oil prices had demonstrated the possibility of 'COMMODITY POWER'. At the heart of the IPC proposals was a Common Fund for commodities, whose aim was to reduce excessive commodity price fluctuations and to maintain prices at levels which were remunerative to producers and equitable to consumers. The Common Fund proposal was not agreed until 1980 and the slowness of UNCTAD member-governments in ratifying the agreement delayed the Common Fund's establishment until 1989, when most COMMODITY AGREEMENTS already had ceased to operate effectively.

Earlier work in UNCTAD, particularly by its Secretary General RAUL PREBISCH, had already established in the public mind a link between commodity policy and the development prospects of many developing countries. Interest had centred on the declining TERMS OF TRADE for primary commodities and on difficulties faced by developing countries in getting market-access

in the developed world, especially for processed commodities. The IPC was designed to:

- 1 provide for the establishment of international stocks of a range of commodities
- 2 set up a Common Fund to finance stock acquisitions
- 3 institute long-term commitments to buy and sell commodities at agreed prices
- 4 improve compensatory financing arrangements for shortfalls in export earnings
- 5 promote measures to encourage the further processing by developing countries of their primary commodities

The Common Fund was intended to provide financial resources to support joint buffer-stock operations for primary commodities of particular importance to developing countries. Eighteen such 'core' commodities were identified, later reduced to ten (cocoa, coffee, copper, cotton, hard fibres, jute, rubber, sugar, tea and tin). It was hoped that considerable cost-reductions could be achieved by operating an integrated stock, with purchases of some commodities being offset by sales of others. When the agreement for the Common Fund was signed in 1980, it had been watered down so that it derived most of its resources from individual commodity agreements rather than providing a significant amount of central financing. This reflected pressure from developed country members of UNCTAD for a 'commodity by commodity' approach. Although existing individual commodity agreements were renewed for cocoa, coffee, sugar and tin, the only new agreement signed was for natural rubber. Other prospective commodity agreements foundered on producer disagreements, as in the case of tea where producer governments in developing countries could not agree on the allocation of export quotas. In some cases, such as copper, markets were highly oligopolistic, with governments and multinational corporations having a powerful influence on price.

By the time the Common Fund came into existence, with headquarters in Amsterdam, primary commodities had experienced a decade of exceptionally low real prices and only

the International Natural Rubber Agreement was still operating in the market. The buffer-stock support provisions of the Common Fund (its 'first window') had become of little importance, and the fund was left to pursue another aspect of its operation, its 'second window'. The second window is designed to provide finance for commodity restructuring, productivity improvement, improved marketing and the encouragement of processing. The intellectual climate in which the IPC was envisaged has changed and it is unlikely that developed countries would now support attempts to stabilize prices at relatively high levels in order to promote the development of the Third World.

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JOHN THOBURN

integration

'Integration' is defined in the *Concise Oxford Dictionary* as 'the combination of diverse elements ...'. Such a definition signals the range of the term, but also much of its ambiguity within political science in general and INTERNATIONAL POLITICAL ECONOMY (IPE) in particular. The problem is that of identifying the nature and extent of the 'combination' that will constitute integration in political and economic affairs.

A particular problem with the notion of integration within IPE is that of the degree of formality that is entailed or required. In some contexts, like that of the EUROPEAN UNION (EU), integration is related to formal, treaty-based and highly constitutionalized developments. When applied to aspects of the international economy, the term often relates to the cumulative consequences of evolving patterns of interaction and transaction, such as trade patterns, that may have little formal basis other than private contracts. The latter approach then opens up the question of how extensive, intensive and well developed do such patterns of interaction and transaction have to be for integration to be deemed to have taken place.

Within IPE, integration can be applied to economic combinations, political associations and various mixtures of the two. Within the economic realm, businesses can increase the level of integration among the diverse activities that they undertake or can become integrated with other firms to produce larger and possibly more wide-ranging enterprises. The level of economic activity within and among 'national' economies can also be increased by the actions of private businesses, the impact of evolving technologies and the decisions of political authorities.

Within the political realm, the development of many contemporary states has been a process of progressive integration, as wider territories have been brought under the increasingly effective control of geographically distinct 'centres of power'. Integration has also taken place between formally separate states or principalities on a voluntary basis, as with the

formation of the Swiss Federation or (until the outbreak of the Civil War) the creation of the United States.

Within the post-World War II era, two areas of integration have attracted particular attention: the formal integration of formerly sovereign states into the EU and the general increase of integration within the world economy (particularly in its financial sphere). The uneven path towards the integration of West Europe's peoples has been accompanied by considerable controversy between functionalists (see FUNCTIONALISM) who believe that developments within the economic and technical spheres generate increasing pressures for integration within the political realm and those on the other side who believe that it is prior political commitments and institution-building that establishes the framework within which other forms of integration can take place.

The course of global economic and financial integration in the post-war world has generated similar controversies to those engendered by European integration. Here, again, interpretations that are functionalist in essence are countered by those 'politicists' who point to the effective post-war HEGEMONY of the United States and its institutional representation as the primary source of the peace, stability and pro-market trajectory that created the basic framework within which international trade could expand, MULTINATIONAL CORPORATIONS (MNCs) and their FOREIGN DIRECT INVESTMENT (FDI) flourish, and financial integration advance to its current levels.

Controversies about the sources of integration globally or within regions such as Europe underpin uncertainties about the levels of integration that have actually been attained and their ultimate durability. Fierce debates about the nature and extent of GLOBALIZATION illustrate the uncertainties about the contemporary level of integration within the global economy, with some believing that global integration has now become considerable, irresistible and irreversible, while others argue that global integration remains incomplete, inconsistent and vulnerable to a range of disruptive influences and developments.

The EU also attracts controversy. A significant body of observers now believe that the EU has achieved an irreversible momentum towards greater integration, durable institutions and the creation of a harmonious community of fellow citizens. More sceptical analysts contend, however, that the EU remains a hesitant and incomplete experiment, with flawed institutions and the persistence of 'national' agendas in the decision-making of authoritative bodies like the COUNCIL OF MINISTERS.

Integration is thus a potentially tricky term that can be applied (and possibly misapplied) to a wide range of developments within the world's economic and political systems. The level of formalization of integration is one area of diversity and potential difficulty. The sources of integration, at all levels, also remain highly controversial. The durability of established patterns of integration is also a complex issue, as the sharp reversal of the then existing levels of international economic integration with the outbreak of World War I and the equally traumatic political schism of the American Civil War – or more recently the breakdown of the former Yugoslavia – illustrate.

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R.J. BARRY JONES

intellectual property rights (IPRs)

When knowledge becomes subject to ownership, intellectual property rights (IPRs) express ownership's legal benefits. Like material property, these rights are often justified on the grounds that ownership promotes the efficient use of resources. Intellectual property may also be justified as the reward for intellectual labour (based on Locke's discussion of property as labour's just desert) or as the inalienable expression of self (from Hegel's argument that individuals define themselves through their control of property).

IPRs are divided into two groups: industrial (PATENTS) and literary or artistic (copyrights). This is conventionally presented as the difference between patent's protection of an idea and copyright's protection of its expression. Patentable knowledge must fulfil three criteria: newness, non-obviousness, applicability. As most ideas applied in economic processes are linked to previous innovations, who developed an idea first is frequently disputed. Establishing priority identifies when an idea was new and who owns its legitimate IPRs, provided it has some use and is not deemed obvious. Copyright, while easier to prove (comparison of two expressions will reveal unlawful copying once priority has been settled), offers less protection as the same idea may be expressed differently.

TRADE-RELATED INTELLECTUAL PROPERTY RIGHTS (TRIPS) are now overseen by the WORLD TRADE ORGANIZATION (WTO) which intends to harmonize legislation within its signatory states. In these negotiations, IPRs are recognized only as private rights, excluding knowledge, ideas and innovations that take place within the public realm (or intellectual commons). IPRs are recognized only when knowledge has the potential to generate profits, through economic activity. The balance between private reward and public interest is traditionally expressed through time limits on IPRs. But still many critics fear that when socially available (public or traditional) knowledge is incorporated into new products, it will

become subject to ownership rights. An incorporation of knowledge from the public realm into intellectual property is sometimes identified as a form of intellectual ENCLOSURE.

IPRs are disputed and argued about as, increasingly, ECONOMIC POWER in the global economy (and in its KNOWLEDGE STRUCTURE) is flowing to those who control the knowledge necessary to operate successfully in global industries and/or services. As the cycle of innovation has speeded up, the time available to profit from a new idea is lessening. Ideas need to be husbanded and protected more vigorously for their short profitable life. How, and what, knowledge becomes intellectual property and the balance between the private rewards and social benefits of ideas are at the centre of the political economy of the KNOWLEDGE INDUSTRIES.

See also:

information society/economy; property rights; Universal Copyright Convention (UCC); World Intellectual Property Organization (WIPO)

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CHRISTOPHER MAY

Inter-American Development Bank (IDB)

The IDB falls squarely within the US sphere of influence. The United States holds about a third of the votes in the IDB and its votes are needed for passage of resolutions in the IDB's soft-loan window, the Fund for Special Operations (FSO). Moreover, while most of its operations occur in Central and South America, the IDB is headquartered in Washington, D.C. Established in 1959, the IDB is the oldest RDB. US influence over IDB policy-making goes well beyond its preponderance of voting weight. Many observers have pointed out that it is not possible for the IDB to serve the interests of regional members while the United States dominates its formal and informal decision-making processes.

Currently, twenty-eight regional and eighteen non-regional states are members of the IDB. An agreement enacted in 1976 allowed the membership of Canada and non-regional members. Recently, the number of members on the Board of Directors was increased from twelve to fourteen. As is the case in other RDBs, the IDB weights members' votes in favour of regional members. Each member has 135 base votes and a single vote for each share of capital it subscribes. In cases of proposed capital increases, the addition of new members and resolutions pending in the FSO, a 75 per cent special majority in the Board of Governors is required. Hence the United States – with about a third of the votes – has a *de facto* veto in the IDB's Board of Governors.

JONATHAN R. STRAND

Inter-Bank On-line System (IBOS)

The Inter-Bank On-line System (IBOS) is a cash-management consortium created in 1991 by Banco Santander of Spain and the Royal Bank of Scotland. IBOS serves both private and corporate customers through associate

banks in the European Union and the United States. Participation in IBOS involves the use of proprietary telecommunications software that enables instantaneous transfers of funds between accounts in the network. IBOS and other payments systems like EUROGIRO and TIPA-NET further the integration of national economies by reducing barriers to cross-border trade through rapid transfers of funds and transparent commission charges.

CAMERON G. THIES

interconnectedness

Interconnectedness is a condition in which otherwise separate social units are linked together through material exchanges and information flows. The interlinkage is such that occurrences in one unit have effects on others: consequences of actions and decisions are transmitted beyond the unit in which they are taken. In that respect, units are interconnected. A structured – that is, a recurring and patterned – interconnectedness is a necessary condition for and, hence, one definitional feature of a social *system*.

The academic field of international political economy (IPE) rests on the foundational assumption of an international political-economic system. This means the assumption of structured interconnectedness among social units, which are generally viewed as national political economies. Through trade, investment, human migration, technological linkages, communications, and other transactions and flows, national political economies are interconnected and, accordingly, affected by one another. In the complete absence of such interconnectedness – in a world of total AUTARKY and wholly CLOSED ECONOMIES – there would be no IPE. Interconnectedness, then, is a foundational concept. As such, it is not a term that figures very prominently in analysis. For example, there are virtually no efforts to develop theories of interconnectedness *per se*. Instead, the concept remains largely in the background as an assumed systemic condition.

However, there are at least three ways in which interconnectedness is of analytical importance. First, it serves as a necessary but not sufficient condition for a family of analytical concepts: INTEGRATION, INTERDEPENDENCE and GLOBALIZATION. Each of those conditions presupposes interconnectedness, but each is also understood conceptually as being more than just interconnectedness. For example, in seminal work Karl Deutsch and his colleagues identify a set of conditions necessary for international integration, only one of which is interconnectedness (called 'mutual relevance' by them); Robert Keohane and Joseph Nye are very explicit in making a distinction when they define interdependence as interconnectedness *plus* significant reciprocal costly effects. Many treatments of globalization see it as a further deepening of interdependence, making even clearer the insufficient but necessary condition of interconnectedness. While these examples are not universally accepted definitions of the respective concepts, they illustrate the key point, on which there is no substantial disagreement, that international political-economic interconnectedness is a necessary basis for, but is not equivalent to, international integration, interdependence and globalization.

Second, because interconnectedness varies over time and between units, analysts are keenly attentive to the mechanisms of international political-economic linkage. Factors that influence the depth and scope of interconnecting flows and exchanges, as well as factors that affect the ways in which and the degree to which such flows and exchanges transmit effects among national political economies, are central focuses of the field of IPE. As a result, the internationalization of technology and information/knowledge becomes an important analytical object, as do the creation and operation of rules, agreements and political arrangements (such as international regimes) that facilitate and/or regulate the international movement of goods, services, capital and labour. Very little, if any, of the extensive research on these topics approaches the issue explicitly in terms of

interconnectedness. But it is only because of variations in interconnectedness that these topics are analytically important.

A third way in which interconnectedness plays a significant analytical role is in underlying, again generally only tacitly, two major lines of theoretical development. One concerns STRATEGIC INTERACTION and is expressed in work on GAME THEORY, on problems of COLLECTIVE ACTION and on issues of international cooperation and coordination. Strategic interaction presupposes appreciable interconnectedness. The latter is a necessary condition for the former and, in turn, for its manifestation in patterns of international political-economic cooperation and conflict. Another line of theoretical development is often referred to as systemic theory and takes a wide variety of forms, from the WORLD-SYSTEMS THEORY of IMMANUEL WALLERSTEIN to the constructivist social theory pioneered by Alexander Wendt in international relations. Across its many forms, systemic theory is attentive to subtle, otherwise often overlooked, faces of interconnectedness. This means seeing seemingly unrelated phenomena, unintended consequences and social difference as well as convergence, as systemically produced outcomes. Systemic theory is attentive to such systemic subtleties only because of its proponents' awareness of the complexities of social interconnectedness.

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RAYMOND D. DUVALL

interdependence

'Interdependence' has been and remains characteristic of many aspects of human activity. Historically, the term has been employed as readily in the social, political and security realm as it has been in the specifically economic sphere. The surge of interest in the idea of interdependence from the mid-1970s onwards, however, has owed most to increasing concerns about the apparent growth of international economic interdependence and the impact of human activity on the natural environment. The term 'interdependence' has often been used in a seriously imprecise manner. Its definition has also been subject to considerable controversy within the field of international political economy (IPE).

One school of thought equates interdependence with patterns of INTERCONNECTEDNESS among peoples. Interdependence, by such a definition, is to be identified simply in the patterns of association and interaction among actors of various kinds. A range of measures might indicate such interconnectedness: numbers of telephone calls, flow of goods and services, or correlations among such indicators as the rates of interest paid within separate national economies. There are two basic problems with the view of interdependence as interconnectedness. The first widely held view is that it contradicts the common usage and understanding of the term. The second and related argument is that while many patterns of interconnectedness may be quite intense, they are not self-evidently of great significance.

The alternative and more traditional approach to interdependence defines it in terms of the existence of significant dependencies between or among those who experience the phenomenon. Interdependence is thus seen as a condition of mutual DEPENDENCE between two or more actors or agents. A two-stage definition of interdependence is thus necessary: the first stage is the definition of dependence; the second, a definition of interdependence as a condition of mutual dependence. Drawing on the earlier work of ROBERT KEOHANE and

Joseph Nye, and the later contributions of R.J. Barry Jones and Peter Willets, the following basic definition can be offered:

Dependence exists for any actor when a satisfactory outcome on any matter of significance for that actor requires an appropriate situation or development elsewhere.

Interdependence exists for a grouping of two or more actors when each is dependent on at least one other member of that group for satisfactory outcomes on any issue (s) of concern.

These somewhat abstract definitions embrace the full range of circumstances in their forms and significance. The substance and salience of instances of economic dependence and interdependence is particularly wide-ranging, as the entry on ECONOMIC INTERDEPENDENCE makes clear. Individuals within most modern societies are highly dependent on an incalculably wide range of their fellows for the supply of the great majority of the goods and services that they consume in their daily lives. Societies and states may also experience a wide range of dependencies and find that other societies or states are also dependent on them. However, the degree of intersocietal or international dependence varies considerably, as does the extent of balance and/or symmetry within specific patterns of bilateral interdependence.

Variable patterns of dependence and imbalanced levels of interdependence are common within contemporary international relations (IR) and lie at the heart of much of the unevenness of power and influence, and advantage and disadvantage, within the international system. Many international tensions and conflicts thus have a complex connection with prevailing patterns of dependence and interdependence – many of which assume the form of imbalanced and asymmetrical economic interdependencies or even straight dependencies. Strategic dependencies, seriously imbalanced political relationships or substantial asymmetries in patterns of cultural influence among societies may form the foundations for resentment and ultimately conflict.

Political interdependence

Interdependencies have long been woven into the fabric of IR and lie at the heart of many of the basic concepts with which they have been traditionally analysed. Mutual dependencies are integral to alliances and other forms of association for mutual support within IR. Alliances, cartels and similar relationships (see **ALLIANCES**, **INTER-FIRM: CARTELS**) have long been of importance to all their participants, albeit often of uneven and changing significance to one or other of the parties. Niccolò Machiavelli, moreover, warned the 'princes' of the dangers of alliances with substantially more powerful states. The asymmetrical interdependence (see **INTERDEPENDENCE**, **ASYMMETRICAL**) inherent in such liaisons might render the weaker partner(s) vulnerable to unwanted and irresistible pressures from the stronger.

It is not only friendly relationships that generate interdependence, however, for it might also form an important part of an adversarial relationship. Mutual deterrence has long formed the most pure and dramatic form of balanced and symmetrical interdependence (see **INTERDEPENDENCE**, **SYMMETRICAL**). The dependence of both sides in any potential conflict on mutual restraint from acts of aggression is a form of interdependence that has become ever more pressing as the world has entered an era of mass destruction.

The desirability of mutual restraint was not entirely lost on earlier generations of political leaders, however. Deterrence has achieved some, although far from consistent, success in preventing the outbreak of hostilities at times of increasing tension. A wider acceptance of the need for restraint has also been demonstrated in the repeated efforts to regulate warfare and its barbaric features. The Geneva Conventions (1864-1949) were the most prominent examples of a series of efforts to translate the humanitarian interdependence into formal international treaties. There has also been a series of examples of informal mutual restraint at times of war, when all sides recognized the disutility of employing forms of combat that were generally available and would

therefore be likely to provoke retaliation in kind if unleashed. The general non-use of poison gas during World War II exemplifies such prudential restraint.

There is also a rather more elusive form of interdependence that operates in human and international relationships. Many power relationships do not involve **COERCION** immediately and directly. Rather, they depend on a multi-phase form of interdependence in which the 'powerful' is dependent on the compliance of the other party for the achievement of some desired outcome, while the subordinate partner perceives itself to be dependent on the continual restraint of the powerful partner from some possible form of coercion for the achievement of an acceptable future state of affairs.

Interdependence in the modern states system

Interdependencies also lie at the heart of the modern international system. The emergence of the modern system of **NATION-STATES**, as encapsulated in the treaties of Westphalia (1648), enshrined the principles of mutual recognition of state **SOVEREIGNTY** and general restraint among the states of the European theatre (see **WESTPHALIA**, **TREATIES OF**). This contrasted with earlier patterns of migratory conquests, which involved the elimination or total subordination and ultimate absorption of the peoples formerly inhabiting occupied lands. It also marked an end to an era of attempts by states, or their rulers, to force the conversion of the peoples of other states to their particular religious persuasion. The principles of mutual recognition of sovereignty and other forms of restraint were never fully honoured in practice, but they did mark a new reference point in the ideology of the European states system and the international law that partially regulated the behaviour of its members (see **LAW, INTERNATIONAL**).

In the view of one school of IR students, the interdependence on which this system of states rested formed the basis of and the continuing need for a special form of international society. The culture and increasingly ritualized practices of modern European diplomacy both

underpinned and reflected such a peculiar form of 'society'. The reality of such a society beyond its diplomatic manifestations has, however, been disputed by adherents of contending schools of thought and has been thrown into question by the violent cataclysms of the twentieth century.

Complex forms of interdependence

The preceding discussion has so far covered a range of interdependencies that embraces simple bilateral forms of interdependence and more complex forms that involve numerous actors within multifaceted relations of mutual involvement and dependence. How far such multidimensional patterns aggregate into new conditions that are far more than the mere sum of their parts is a complex and controversial question. That said, a number of influential concepts have been developed to offer insight into the nature and implications of complex patterns of interdependence and interconnectedness in the contemporary world.

The concept of 'complex interdependence' developed by Robert Keohane and Joseph Nye (see INTERDEPENDENCE, COMPLEX) sought to provide new insights into a new and highly significant condition within the international system: a condition in which the traditional hierarchy of policy issues has been dissolved, multiple channels of contact between peoples have been established and the utility of force has been dramatically reduced. Patterns of interdependence were clearly central to such a condition: their density and salience configuring a new set of constraints and opportunities for the states that interacted in the contemporary system.

Keohane and Nye presented complex interdependence as an 'IDEAL TYPE' with no necessary, simple correspondence in reality. However, with such statements as 'we shall argue that complex interdependence sometimes comes closer to reality than does realism' (Keohane and Nye, 1977: 23), they left the door sufficiently ajar for those who were so minded to proclaim complex interdependence as the model of a new international reality. Later attempts to clarify the concept of complex interdependence

as a clearly heuristic ideal-type model (Keohane and Nye, 1987) could not halt the deepening intellectual hold of such a view of the international condition. Indeed, in a later paper with Stanley Hoffman on developments within the EUROPEAN COMMUNITY (EC), Robert Keohane himself employed the concept of complex interdependence as a signifier of an empirical condition: 'boundaries are difficult to draw in a world of complex interdependence' (Keohane and Hoffman, 1991: 1-39).

Much of the flavour of the earlier concept of complex interdependence has found echoes in the concept of GLOBALIZATION that has found more recent popularity. This concept again blends notions of multidimensional interdependencies and interconnections into a vision of a world in which powerful, and possibly irreversible, processes are well advanced with profound and largely irresistible consequences for all peoples and states – a concept that (as with complex interdependence) has been challenged for its conceptual clarity and empirical veracity.

The problematical status of the notions of complex interdependence and globalization illustrates the essentially interpretive bases of such concepts, including the foundational notion of interdependence. Very few dependencies or interdependencies in the contemporary international political economy are so substantial in substance and dramatic in form as to escape any uncertainty or even ambiguity. As the discussion of sensitivity and vulnerability in the entry on 'economic interdependence' makes clear, very few dependencies can be reduced or even eliminated – even with time and effort. Interpretation and considerable contextual sensitivity are thus central to any judgement about any condition of dependence or interdependence and its supposed implications.

The interpretative bases of most judgements about dependence or interdependence may suggest a further stage in judgements about the status of the idea of interdependence: that it constitutes a construct that carries powerful and contentious analytical and political connotations. Such a critical view of the idea of interdependence highlights the emphasis on mutuality of interest and circumstance that is

often central to the usage of the concept and that has the effect of deflecting attention from the extent of division and conflict within much of the human condition. Interdependence, particularly in its elaborated forms (such as the idea of complex interdependence), is thus deemed to be an obfuscatory construct that intentionally simplifies a far more complex and inherently conflictful reality.

The theoretical contexts within which notions of interdependence are located are also significant and controversial. Empiricist views of contemporary interdependence require no initial assumptions about the ultimate nature of reality, merely the presumption that reality can be apprehended through direct empirical observation. The simplest forms of an empiricist approach to interdependence are atomistic, with significance and legitimacy attributed only to simple conditions of dependence or bilateral interdependence, to the exclusion of ambitious ideas about the nature and reality of more complex, aggregate phenomena.

Diametrically opposed to atomistic views of contemporary interdependence are holistic approaches. Holism accepts and emphasizes the reality and practical significance of aggregate phenomena, like systems, structures or a globalized world. Such aggregate phenomena have, in some senses, a life of their own and do not remain dependent on the intentional action of any one of their members.

The simpler form of such holism is that of empirical HOLISM, which merely asserts that aggregate phenomena operate as if they were more than the mere sum of their component parts. More ambitious forms of holism, however, invoke forces and processes that operate behind the apparent variability and complexity of everyday life. These forms of realist holism, claim to be able to get behind superficial appearances and identify the true nature of 'reality' – they include most Marxist approaches to contemporary interdependence.

See also:

Marxism-Leninism; sensitivity, economic; vulnerability, economic

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R.J. BARRY JONES

interdependence, asymmetrical

Asymmetrical interdependence describes a situation of INTERDEPENDENCE in which the costs of maintaining or disrupting relations differ for those involved. Asymmetry may merely imply differences in the composition of those costs (for example, economic versus security costs), rather than the total amount. However, an asymmetric relationship is often an imbalanced relationship in which the total level of costs is greater for one side. This leads

some authors to use the terms 'asymmetry' and 'imbalance' interchangeably. If the asymmetry is very great, it may be more accurate to characterize the situation as one of dominance rather than interdependence.

AMANDA DICKINS

interdependence, complex

'Complex interdependence' describes the situation in which the rising level and complex character of INTERDEPENDENCE has transformed the nature of the international system. However, it has been used in different ways, creating ambiguity about its precise meaning. As a heuristic tool it is sometimes used merely as a metaphor or an 'IDEAL TYPE'. But it has also been used in empirical statements about the current condition of the world, as well as evocations of probable or desirable future worlds.

The concept of complex interdependence was first developed by ROBERT KEOHANE and Joseph Nye, in their influential 1977 book *Power and Interdependence*. This work was written at a time when economic relations had come to the fore, as the 1973 oil crisis and high commodity prices demonstrated the dependence of the developed world on raw materials from the less developed countries. Keohane and Nye sought to develop a framework for understanding the changes that they perceived in the nature of international politics.

As later summarized by Keohane and Nye, the concept of complex interdependence had 'three main characteristics': (1) state-policy goals are not arranged in stable hierarchies, but are subject to trade-offs; (2) the existence of multiple channels of contact between societies expands the range of policy instruments, thus limiting the ability of foreign offices tightly to control foreign relations, and (3) military force is largely irrelevant (Keohane and Nye, 1987: 737-8).

Under complex interdependence, the absence of a hierarchy of significance among state-policy goals results from the increasing scope and complexity of the international agenda. Economic or environmental issues are

increasingly important and military security is no longer the sole or dominant issue. Moreover, military force declines in effectiveness, partly because it has become more costly to use, but also because it cannot secure the new economic or environmental goals. However, Keohane and Nye failed to pay attention to the politics of interest-formation that cause changes in policy goals, a gap they later blamed on their attempt to develop a parsimonious systemic perspective.

Their systemic focus further weakened their analysis by leading them to maintain a distinction between the systemic and the domestic, even though that distinction breaks down under complex interdependence. States can no longer be treated as unitary actors because the channels of communication between societies have expanded. These channels now extend beyond the traditional category of 'communications', to encompass both the 'transgovernmental' (informal ties between governments) and the 'transnational' (ties involving non-governmental elites and organizations, such as corporations).

Despite widespread interest in and discussion of *Power and Interdependence*, complex interdependence did not provide a satisfactory framework for research. Furthermore, the salience of complex interdependence appeared to decline in the 1980s, as security issues once again took centre-stage. The research agenda was focused instead on REGIME THEORY, which provided a better framework for research and could accommodate an emphasis on the self-interest of states.

Reviewing their own work in 1987, Keohane and Nye sought to emphasize that they had intended complex interdependence to be understood merely as an 'ideal type'. By this, they meant that it was simply one descriptive tool which complemented the others in a toolbox that also included REALISM. They claimed that complex interdependence was meant to be helpful in describing the world 'rather than an accurate description of world politics or a forecast of trends' (Keohane and Nye, 1987: 737). Instead, they suggested that NEO-REALISM provided a better description of the structure of the international system, while liberal

theories (such as complex interdependence) could complement this with a description of systemic processes.

Nonetheless, Keohane and Nye's original work had also made broad claims for the significance of complex interdependence. Thus, despite their caveats, they 'left the door sufficiently ajar for those who were so minded to proclaim complex interdependence as the model of the new international reality' (Jones, 1995: 191–2). Indeed, in later work on the European Union (EU), Keohane speaks of 'a world of complex interdependence'.

Such ambiguity stems, in part, from the fact that complex interdependence inevitably encounters 'the methodological issues raised by the contrast between atomistic and holistic approaches to international interdependence' (Jones, 1995: 11; see ATOMISM; HOLISM). It is impossible to observe 'complex interdependence' directly. What can be observed is the simultaneous growth in the density and significance of international interactions across a number of different issue-areas. However, it is not clear when it becomes accurate or helpful to interpret this as a thoroughgoing transformation of the nature of the international system. These problems can also be seen in more recent work on GLOBALIZATION, of which complex interdependence is an important precursor.

See also:

dependence: economic interdependence

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- Keohane, R.O. and Nye, J.S. (1987) 'Power and interdependence revisited', *International Organization* 41, 4: 725–53. The inventors of complex interdependence provide a useful summary and interesting criticisms in this re-evaluation of their own seminal work. Most of the substance of this article is reproduced as the 'Afterword' in Keohane and Nye (1989).
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AMANDA DICKINS

interdependence, imbalanced

A situation of INTERDEPENDENCE in which one side is more dependent than the other(s) because the costs involved in maintaining or disrupting the relationship are greater for them. Imbalance arises from an inequality in the overall level of costs: balance is still possible in an asymmetric relationship where the composition of the costs differs. However, imbalance and asymmetry are closely correlated in real life and some authors use them interchangeably. If the imbalance is very great, it may be more accurate to characterize the situation as one of dominance rather than interdependence.

See also:

dependence; economic interdependence; interdependence, asymmetrical

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interdependence, moral

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AMANDA DICKINS

interdependence, moral

Communitarian philosophers argue that moral duty is restricted to one's community or perhaps one's nation. IMMANUEL KANT argued that international economic interdependence meant that cosmopolitan rights could be extended abroad. Charles Beitz (1979) wrote that moral duty and justice go beyond national borders because interdependence constitutes social cooperation and produces significant benefits and burdens that would not exist if states were economically autarkic (see AUTARKY). Other cosmopolitans argue that all humans are morally interdependent because they share qualities like reason and conceptions of what is right and good.

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PAUL G. HARRIS

interdependence, symmetrical

Symmetrical interdependence describes a situation of INTERDEPENDENCE in which each side of the relationship is equally sensitive to the behaviour of the other(s). The costs involved in maintaining or disrupting the relations are roughly identical for each of the parties involved. Most authors suggest that situations of perfectly symmetrical interdependence are unusual in international relations: asymmetrical interdependence (see INTERDEPENDENCE,

ASYMMETRICAL) is thought to be much more common. Mutual nuclear deterrence is a rare example of symmetrical interdependence, in which each state is dependent for its survival on the forbearance of the other(s) in avoiding the use of nuclear weapons.

See also:

economic interdependence

Further reading

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AMANDA DICKINS

interest rates

For borrowers, the rate of interest basically measures the cost of borrowing for investment purposes: the lower that cost of borrowing is, other things being equal, the more borrowers will wish to invest. For lenders, the rate of interest measures the return which will be received when their wealth is invested: the higher the return, the more lenders will wish to invest. At any one time there will be a whole set of different interest rates, each associated with a particular form of lending: bank loans, building society accounts, short-term government debt and so on. Some may carry greater risks than others and this will be reflected in the level of the interest rate. Thus, the rate of interest paid on any type of loan is essentially the price which is paid for the use of that money.

From the point of view of national monetary authorities, interest rates are at the heart of any strategy which they may select in order to influence business conditions and economic activity. Interest rates affect capital movements as well as the rate of INFLATION and, in general, states wish to achieve low interest-rate

targets. In large part, this is due to the fact that high interest rates can cause difficulties in the financial system. First, they may discourage investment plans and therefore reduce long-term growth. Second, they add to the costs of production, to the costs of house purchase and generally to the cost of living. They are thus cost inflationary. Third, they are politically unpopular because the public does not like to pay higher interest rates out of a set income. Fourth, high interest rates encourage inflows of money from abroad. This increases the amount of money which banks have at their disposal to lend. Fifth, inflows of money from abroad drive up the EXCHANGE RATE, which can be very damaging for export industries. The debt crisis of the 1980s among LESS-DEVELOPED COUNTRIES (LDCs) is one example of the impact which high interest rates can have.

The increasing GLOBALIZATION of financial markets has led to interest-rate deregulation which may result in financial-market instability. First, because interest-rate values can change due to changes in time preference. When money is lent, this represents a sacrifice of consumption at the present time. The stronger the consumers' preference for present as opposed to future consumption, the more they must be paid to induce them to postpone consumption – that is, the higher must be the rate of interest. Second, interest-rate deregulation increases the possibility of a default, because the lender may not be absolutely sure that the borrower will repay the loan due to the possibility of a sudden increase in interest rates. Third, if inflation is anticipated, the lender will wish to take account of a fall in the value of money by raising the interest rate. The process of financial globalization, then, has changed the very nature of the importance of interest rates in contemporary international economic policy-making.

See also:

capital mobility; consumption; debt crisis; globalization; inflation; investment; monetary policies; risk

ALISON M.S. WATSON

Intergovernmental Council of Copper Exporting Countries (CIPEC)

The Conseil Intergouvernemental des Pays Exportateurs de Cuivre (CIPEC) was formed in 1967 by the four main developing-country exporters of copper: Chile, Zambia, Zaire and Peru (ordered by total exports, 1967). At the time, they accounted for virtually all of the exports of copper from developing countries, and 53 per cent of total market economy exports of copper. Initially concerned with exchanging information and promoting government control of the copper industry, CIPEC began attempting to control world market prices, through supply restriction in the 1970s and later through efforts to negotiate a commodity agreement. None of these efforts have brought much success.

See also:

Organization of Petroleum Exporting Countries (OPEC)

JOHN M. TALBOT

intermediate goods

Inputs are materials and services of factors of production that are used in the production process. A firm can use as inputs goods that are produced by other firms. These goods are intermediate goods. They are sold from business to business, as opposed to final goods, which are sold to consumers.

M. PETER VAN DER HOEK

INTERMEDIATE TECHNOLOGY *see*
appropriate technology

intermediation

Institutions that perform financial intermediation link borrowers with savers or, more generally, serve as brokers between the holders of different kinds of assets. Financial intermediaries include commercial banks which accept deposits from savers and make loans to borrowers. Intermediation may be direct or indirect, depending largely on whether the financial firm holds assets in its own portfolio (direct) or simply serves as a 'middle-man' between savers and investors (indirect).

See also:

financial institutions

Further reading

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PETER DOMBROWSKI

INTERNAL COLONIALISM *see* colonialism, internal

International Air Transport Association (IATA)

Concerned that critical economic questions were not answered by the INTERNATIONAL CIVIL AVIATION ORGANIZATION (ICAO), the world's airlines - with the full support of their governments - met in Havana, Cuba, where they created the International Air Transport Association (IATA) to ensure they had a voice at ICAO, to serve as a forum for solving common problems, and to coordinate international rates and fares. Established by a special act of the Canadian Parliament in September 1945, IATA held regular 'traffic conferences'

where air fares were multilaterally negotiated. Since most of its airline members were state-owned, these 'traffic conferences' were clearly state-sanctioned, which helped alleviate fears that powerful aviation states - for example, the United States - would charge unreasonably low fares to push weaker states out of the air-transport market. Economic deregulation of air transport, accompanied by the privatization of many airlines, has rendered IATA powerless except in the most mundane of trade-association activities. Today, it does little more than collect data, conduct research, sponsor forums, and lobby national and regional governments.

VICKI L. GOLICH

International Atomic Energy Agency (IAEA)

As a specialized agency within the United Nations, the International Atomic Energy Agency (IAEA) was brought into being in 1957 to encourage cooperation among the atomic powers and developing states, and to ensure that nuclear materials would be used for peaceful purposes only and not be diverted to military use. The IAEA was first proposed by President Eisenhower in 1953 in his 'Atoms for Peace' speech before the United Nations General Assembly. The IAEA is the world's central inter-governmental organization, making inspections of nuclear installations in countries suspected of developing nuclear weapons. Its most extensive inspection programme has been undertaken in Iraq, seeking the elimination of Iraqi weapons of mass destruction.

MEHDI PARVIZI AMINEH

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD) *see* World Bank

International Bauxite Association (IBA)

The International Bauxite Association (IBA), headquartered in Kingston, Jamaica, was formed after OPEC's success in 1973. The eleven original members (Australia, the Dominican Republic, Ghana, Guinea, Guyana, Haiti, Indonesia, Jamaica, Sierra Leone, Suriname and Yugoslavia) controlled well over two-thirds of world production. While India joined in the mid-1980s, Haiti and Australia have subsequently left the cartel.

The formation of a strong bauxite cartel is constrained by the fact that a large proportion of bauxite comes from integrated international aluminium firms, each of which has investments in bauxite production in several countries. The companies can skew production and investment in additional capacity to those areas where conditions are most favourable. As a result, the IBA has failed to stabilize, much less increase prices.

ROBERT LOONEY

International Business Machines (IBM)

American computer manufacturer, International Business Machines (IBM), is one of the world's leading suppliers of information-technology and communications products. Beginning life in 1911, IBM first began producing computers in 1951 as a result of contracts with the United States government's Atomic Energy Commission. 'Big Blue', as IBM came to be called, dominated the global mainframe market until the 1980s, when it lost market-share to other manufacturers in speciality areas such as personal computers. When the latter were first introduced, IBM failed to recognize their potential. In the software market, IBM has struggled to compete against the rise of MICROSOFT.

JASON P. ABBOTT

International Centre for the Settlement of Investment Disputes (ICSID)

The International Centre for the Settlement of Investment Disputes (ICSID) is an autonomous international organization, although it is part of the WORLD BANK group and its Administrative Council is chaired by the President of the World Bank. It has a membership of 139 states, all of whom are members of the World Bank.

ICSID was created in 1966 in response to the demand of governments and private investors for a forum for conciliation and arbitration of disputes relating to FOREIGN DIRECT INVESTMENT (FDI). Its function is mainly administrative, in that it assists in the initiation and conduct of proceedings, and it operates according to a convention that establishes its rules of conduct. While only forty-one cases have been submitted to ICSID up to 1997 – recourse to ICSID is voluntary and many cases are settled before formal proceedings begin – its main importance lies in the fact that the convention has the confidence of the vast majority of states and of foreign investors. In fact, arbitration through ICSID is mentioned in the majority of BILATERAL INVESTMENT TREATIES and it is the main mechanism for arbitration of investment disputes in the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), the Cartagena Free Trade Agreement, the Engery Charter Treaty and the Colonia Investment Protocol of MERCOSUR.

JARROD WIENER

International Chamber of Commerce (ICC)

The International Chamber of Commerce (ICC), located in Paris, is an association of the international business community. It was established in 1923 and now has over 7,000 members in thirty states.

The ICC promotes the interests of free

enterprise by acting as a point of contact for the international business community and, through the International Bureau of Chambers of Commerce (IBCC), as a point of contact for chambers of commerce. Subsumed within the ICC are commissions on such diverse areas as advertising, banking and financial services, commercial crime, competition, energy, the environment, intellectual property, trade, investment, taxation, telecommunications and information technology, and transportation.

The ICC conducts research on issues affecting business, such as assessments of proposed legislation, and conveys its views to governments. It is also active in elaborating standard rules for the conduct of international commerce (such as codes of practice and model contracts) to harmonize business practices. Among the most widely used are its INCOTERMS (1990), which defines the meaning of such widely used terms as FREE ON BOARD (F.O.B.) and COST, INSURANCE, FREIGHT (C.I.F.) in terms of the obligations and responsibilities of buyers and sellers. The ICC has also elaborated the Uniform Customs and Practice for Documentary Credits (1983), ICC Rules for Conciliation and Arbitration (1988, 1998) and the Uniform Rules for a Combined Transport Document (1975).

Among the most significant activities of the ICC is the operation from its secretariat in Paris of the ICC International Court of Arbitration. It also operates a special Centre for Maritime Arbitration Organization (IMAO), in cooperation with the Comité Maritime Internationale (CMI), to arbitrate disputes of a maritime nature.

JARROD WIENER

International Civil Aviation Organization (ICAO)

Multilateral management of international air transport long eluded policy-makers. Unlike ocean transport, guided by HUGO GROTIUS' 1640 'freedom-of-the-seas' principle, rules gov-

erning global commercial aviation have been influenced by national security concerns requiring control over proximate airspace. Nevertheless, countries have simultaneously recognized the need to standardize certain technical aspects of commercial aviation, including weather reporting, radio communications, airport design, air traffic control systems, and personnel training and licensing. Early attempts to satisfy both needs – 'airspace sovereignty' and multilateral coordination – led to the International Civil Aviation Organization and the Inter-State Aviation Commission (formed in 1922 and 1923 respectively), each of which foundered on lack of universal membership and an attempt to issue binding regulations.

At the close of World War II, the world's aviation nations tried once more. In 1944, fifty-four nations met at the Chicago Conference to create an institution to govern international commercial air-transport services. Twenty months later, on 4 April 1947, the International Civil Aviation Organization (ICAO) was officially established. Modelled somewhat after its predecessor entities, ICAO explicitly preserved and reinforced the principle of 'airspace sovereignty' by granting ICAO the authority only to recommend standards – their actual implementation was left to national governments. Conferees adopted two 'freedom-of-the-air' principles critical to expanding global commercial aviation. First is the 'right of innocent passage', which grants civil aircraft the right to fly over the territory of another country without landing, provided the overflown country is notified in advance and gives approval. The 'second freedom' permits foreign aircraft to land in another country for technical reasons – for example, refuelling or maintenance – without offering service to or from that point. Operating under the auspices of the UNITED NATIONS (UN), ICAO has resolved several critical technical and safety problems which heretofore hindered the expansion of international commercial aviation. Its member-states have developed universal standards for licensing airline personnel, registering and certifying airworthy aircraft, installing naviga-

tional aids, collecting statistics and exchanging technical information. An escape clause permits countries unable to meet the standards to state that this is the case and to seek assistance from ICAO to implement them.

ICAO was unable to resolve key economic challenges – for example, route rights and fares, carrier frequencies, schedules and capacities. It also failed to adopt the three remaining air freedoms – an airline's right to carry traffic from its country of registry *to* another country; its right to carry traffic *from* another country to its country of registry, and its right to carry traffic between two countries outside its own country of registry as long as the flight originated or terminated in its own country of registry – which would enable airlines to earn a profit on international routes. These freedoms were adopted through bilaterally negotiated Air Transport Agreements, modelled after the Bermuda Agreement between the United States and the United Kingdom. Though some conditions have changed over time, international commercial aviation remains dependent on bilateral agreements, further reinforcing national claims over their proximate airspace.

VICKI L. GOLICH

International Coffee Agreement (ICA)

The International Coffee Agreement (ICA) was probably the most effective of the COMMODITY AGREEMENTS that took the form envisioned by the HAVANA CHARTER. In force between 1962 72 and 1976 89, it regulated world trade in coffee through an export QUOTA system. Rigidities in the quota system hampered the ability of world supplies to adjust to shifts in world demand for different varieties of coffee, leading to a build-up of stocks in some producing countries and discount sales to non-member Soviet bloc countries. This situation caused disagreements between members, who

failed to agree on a renewal of the agreement in 1989.

JOHN M. TALBOT

International Council of Securities Associations (ICSA)

The International Council of Securities Associations (ICSA) was established in 1988 by associations from Japan, Canada, the United States and the United Kingdom. Affiliate members of the INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO), they were dissatisfied with that organization which was dominated by state regulators. Other associations have since joined, including the INTERNATIONAL SECURITIES MARKETS ASSOCIATION (ISMA).

TONY PORTER

international countertrade

International countertrade is a mechanism to facilitate international trade that may otherwise not take place. It occurs in both developed and developing countries, and is prevalent throughout the international political economy. In its generic sense, international countertrade covers exchanges such as barter trade, buy-back, offset, counterpurchase, switch and trading accounts.

International countertrade both presupposes specie and was a concomitant feature of it (not necessarily gold and silver but herbs, metals and minerals which formed a value-basket for exchange in international settlements) in the pre-modern world. It continues to be used in various industries and markets, and estimates suggest it could account for a third of world trade. Most governments are involved in some form of countertrade. These are usually large public projects involving cross-border co-production.

At its most basic, international countertrade allows anyone with something to trade – be it

goods or services, primary resources, people or any form of knowledge – to do business. International countertrade involves some form of reciprocity. Where money is virtually absent, the exporter contracts to acquire back a value proportionally weighted to the original export. The following explains the situation in which one party in an international countertrade exchange requires a cash payment for exported goods. Importer X, requires a number of machines to produce n goods, but cannot pay in hard currency for them. Y is willing to supply the machines through a countertrade if X's government issues a sovereign guarantee to cover the value of the goods. X, using one item or a basket of goods of equal value to the machines is in a position to trade. Z, an international commodity trader, sells the goods held by X. The cost of Y's machines, along with a commission to Z, is deducted from the sale of X's holdings and transferred to Y. Y exports the machines and the trade is complete. International countertrade occurs when: (1) a country experiencing foreign exchange shortages uses it as a tool to procure goods and services from the international market; (2) currency fluctuations make an alternative settlement of exchange attractive; (3) international currency agreements and foreign direct investment regulations need to be overcome; (4) surplus production necessitates recycling outside the domestic market; (5) political risk is a serious possibility; (6) corruption is prevalent; (7) humanitarian necessity to overcome the rigours of sanctions, for example oil for medical supplies in Iraq; (8) TECHNOLOGY TRANSFER cannot be obtained from foreign direct investment; (9) a moral exchange is deemed important or desirable (by avoiding exploitative and excessive profits, and the charging of interest: it has, for example, been used by Muslims for use in the Islamic political economy); (10) a business needs to upgrade its machinery but does not have sufficient funds or access to credit. Further examples of the uses of international countertrade exist; however, little empirical evidence can be supplied. For example, multinational corporations (MNCs) often engage in international countertrade to

avoid certain taxes or duties. To what extent this is a feature of MNCs' operations is difficult to estimate or claim.

International countertrade exchanges are complex and dissimilar and are criticized as such. Unlike barter exchanges, goods or services produced from equipment or knowledge obtained from a countertrade exchange can be sold and returned in part payment along with the balance – made up in goods and services – to the party who initially facilitated the exchange. Due to the complexity of some exchanges, most large contracts involve the services of consultants, agents, trading houses, brokers and suppliers of market intelligence, each contributing a particular specialization.

The WORLD TRADE ORGANIZATION (WTO), formerly the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK have been critical of international countertrade. It has been (and is) viewed as an unnecessary and undesirable exchange in 'the markets'. It is argued that it can, due to its reliance on the exchange of a basket of goods and services, result in unwanted subrogation. The aforementioned institutions assume that the operations of international countertrade are inflexible (actors are limited in choice), due to their reliance on mixed exchanges, and as a result the exchange is potentially derogatory to all involved. What is required, they conclude, is deregulation not circumscription.

International countertrade offers both a parallel and an alternative to the traditional exchanges taking place in the free markets. Where used creatively and without coercion the evidence suggests that countertrade exchanges have been successful. They appear to reduce waste (mental, physical and natural) throughout the international system by allowing essentially non-profit maximizing exchanges to take place. Where governments have demanded a countertrade exchange, the results have been less successful.

The increasing availability of international communications (such as the internet) to increasing numbers of people throughout the world, and not just to the developed West, is

arguably generating a solution to the problem of inefficiency, a factor identified in mainstream economics with regard to non-cash exchanges. Potential traders are increasingly gaining access to an electronic network that promotes the sharing of information and knowledge in relation to countertrade. Many of these sites are sophisticated, offering both windows to display the products and services available, and advice on the logistics of the exchange.

The growth of an international countertrade structure that supplements the worst aspects of the free markets could offer a solution to a number of environmental and social problems. Developments, nevertheless, on this issue will be determined by a range of political, economic, social, environmental and cultural factors. Technological developments both above and below the international system are however reinventing and expanding the use of international countertrade. The survival and continuation of international countertrade suggest its utility and longevity.

See also:

product-cycle model: value theory

Further reading

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PAUL SHEERAN

International Development Association (IDA)

The International Development Association (IDA) is the WORLD BANK group's concessional lending window. Since 1961 it has provided long-term loans at zero interest to the poorest of the developing countries. The overarching goals of IDA lending are to assist countries in reducing POVERTY and in achieving sustainable, broad-based economic growth.

IDA has a strong link with the International Bank for Reconstruction and Development (IBRD), another member of the World Bank group. They share the same staff, the same headquarters, report to the same president and use the same standards when evaluating projects. IDA simply takes its money out of a different 'drawer'. Whereas the IBRD raises most of its funds on the world's financial markets, IDA is funded largely by contributions from the governments of the richer member countries. Additional funds come from IBRD's income and from borrower's repayments of earlier IDA credits. Also, a country must be a member of the IBRD before it can join IDA.

IDA credits have maturities of thirty-five or forty years with a ten-year grace period on repayment of principal. There is no interest charge, but credits do carry a small service charge, around 0.75 per cent on undisbursed balances. When a country's GROSS NATIONAL PRODUCT (GNP) exceeds IDA's eligibility threshold and it becomes creditworthy to borrow from IBRD, it is no longer eligible for IDA's interest-free credits. It may then borrow from IBRD at market-related rates. Some countries are known as 'blend' borrowers.

Three criteria are used to determine which countries are eligible to borrow IDA resources:

- 1 relative poverty, defined as GNP per capita below an established threshold
- 2 lack of creditworthiness to borrow on market terms, or a need for concessional resources to finance the country's development programme

International Energy Agency (IEA)

3 good policy performance, defined as the implementation of economic and social policies that promote growth and poverty reduction

The main factor affecting the allocation of IDA resources among eligible countries is each country's performance in implementing policies for economic growth and poverty reduction. Per capita income is also a factor, with the poorest of the eligible countries receiving higher allocations for a given performance level. Countries of SUB-SAHARAN AFRICA (SSA) with sustained good performances receive a certain priority in the allocation of IDA resources.

The lending allocations are determined on a three-year rolling basis and are used for planning purposes by the World Bank operational departments. The allocations are further tailored in the so-called Country Assistance Strategy to ensure that IDA's lending is consistent with individual countries' opportunities and constraints in using these resources effectively.

The strong link between lending and performance has resulted in an increasing concentration of lending to countries where policy performance is most conducive to effective resource-use. Over the last years, per capita lending to the better performing countries has therefore increased, while lending to the poorest performers has declined.

J.E.C. ENGELBERTS

International Energy Agency (IEA)

The major industrial oil-consuming nations created the International Energy Agency (IEA) in direct response to the oil crisis of autumn 1973, to act as a counterweight to the collective power of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC). The Washington Energy Conference (February 1974) agreed to set up the IEA within the framework of the ORGANISATION FOR ECONOMIC CO-

OPERATION AND DEVELOPMENT (OECD). France, however, refused to join. The main task of the IEA was to prepare an emergency allocation scheme for its members, to be triggered by a 7 per cent shortfall in supplies. It also encouraged cooperation among the consumers, advocated the creation of strategic petroleum reserves and promoted research into alternative energy sources.

However, the next major oil crisis in the winter of 1978-9 did not cause a supply shortage: the main problem was panic buying on the world's SPOT MARKETS, which pushed prices up three-fold in a matter of months. The IEA unsuccessfully urged companies and consumers to follow a policy of restraint. In later crises, such as the Iran-Iraq war (1980-8) and the Iraqi invasion of Kuwait (1990), the oil market did not demonstrate so much volatility. In these crises, as in 1979, the IEA played a useful role in promoting cooperation and providing a forum for negotiation, but it never pursued a confrontational policy towards OPEC as had been envisaged by some when it was first discussed.

See also:

Gulf War

Further reading

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FIONA VENN

International Federation of Stock Exchanges (FIBV)

The International Federation of Stock Exchanges, also known as the Fédération Internationale des Bourses de Valeurs (FIBV), was founded in 1961, is headquartered in Paris and promotes self-regulation and information shar-

ing. Its member stock-exchanges represent over 95 per cent of world stock-exchange capitalization.

TONY PORTER

International Finance Corporation (IFC)

The International Finance Corporation (IFC) is a member of the WORLD BANK group, although legally and financially independent from the other members. It was established in 1956 with a particular focus on the promotion of private economic development by encouraging the growth of productive enterprise and efficient capital markets in its member countries.

Three types of activities by the IFC can be distinguished: financing private-sector projects, helping companies in the developing world to mobilize financing in the international financial markets, and providing advice and technical assistance to businesses and governments.

The IFC only participates in investments when it can make a special contribution, complementing the role of market operators. Although the IFC primarily deals with private-sector projects, it may provide finance to companies with some government ownership, provided there is private-sector participation and the venture is run on a commercial basis.

J.E.C. ENGELBERTS

International Fund for Agricultural Development (IFAD)

The International Fund for Agricultural Development (IFAD) was established in 1976 and started operating in 1977. It is a specialized agency of the United Nations, based in Rome, aiming to fund rural development programmes in THIRD WORLD countries to increase their food production and help end chronic hunger and malnutrition. The decision not to entrust

International Labour Organization (ILO)

this mandate to the FOOD AND AGRICULTURE ORGANIZATION (FAO) was partly based on the desire to involve the oil-rich ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) directly in running and financing a UN development agency. The IFAD consists of three categories of members: 21 ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) industrialized countries, 12 OPEC members and 111 other developing countries. Its supreme authority is the governing council, where all member states are represented. Some of the IFAD's projects are co-financed by the International Bank for Reconstruction and Development (IBRD; see WORLD BANK) and also by REGIONAL DEVELOPMENT BANKS. However, disputes on their financial contributions have deeply divided the OECD and OPEC members of IFAD.

MEHDI PARVIZI AMINEH

INTERNATIONAL LABOUR MIGRATION see guest worker system; migration, international

International Labour Organization (ILO)

Immediately following World War I, British, French and German employers actively promoted the concept of an international organization that would advance international labour standards (ILS). They felt that they could not compete effectively with companies in nations that failed to establish ILS (Ramm 1986). The rise of Bolshevism (see BOLSHIEVIK) and the restiveness of the working class in most European nations added to their concerns. Proper labour standards were viewed as a counter to 'the revolutionary ferment that was in the air' (Butler 1950). These economic and political pressures resulted in the concept of international labour legislation taking root. In 1919, Article XIII of the Treaty of Paris established the ILO. This was the first

multilateral agreement to internationalize labour standards (Charnovitz 1994).

The years immediately following World War II were significant, for this was the period when the ILO adopted key conventions that specified *democratic* labour rights as the benchmark. Conventions 87 and 98 on freedom of association and collective-bargaining rights defined this democratic orientation. The former asserts that citizens have the right to establish TRADE UNIONS 'of their own choosing without previous authorization' by either the state or employers. The latter complements this core right by stating that collective bargaining is only effective when trade unions are allowed to operate free of employer interference. The nature of such interference is clearly defined.

The contradiction between this democratic orientation and the unilateral labour-market regulation of authoritarian regimes is contested in the ILO and in the newly established WORLD TRADE ORGANIZATION (WTO). ILO conventions emphasize liberty, independence and worker representation, whereas authoritarian systems rely on coercion through consolidating employer and state power over workers' organization. Debate over trade LIBERALIZATION has brought these contrasting perspectives into sharp focus. An attempt by the United States to link ILS to trade relations by empowering the WTO to impose sanctions on nations, which would have denied these rights, was defeated by an alliance of developing nations. The adoption of a counter-resolution at the WTO shifted the focus to the ILO, as the promoter and guardian of ILS. However, unlike the WTO, the ILO has no regulatory powers. The organization's approach is based on the principles of dialogue, cooperation and moral persuasion, backed by an extensive programme of technical assistance. The ILO Governing Body is presently exploring methods of protecting ILS, given the absence of powers to impose sanctions.

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ROB LAMBERT

International Maritime Organization (IMO)

As a specialized agency of the UNITED NATIONS (UN), the International Maritime Organization (IMO) is the principal international organization governing international maritime safety and the prevention of marine pollution from ships. The IMO also deals with issues of liability and compensation and serves to facilitate international maritime traffic.

Established in Geneva in 1948 but with its permanent headquarters in London, the IMO (formerly IMCO – the Inter-Governmental Maritime Consultative Organization) first met in 1959. At the present time, IMO includes 156 member-states, all of whom are members of the Assembly which normally meets every one or two years. A Council of thirty-two member-states serves as the governing body, preparing the budget and programme of action, which are ratified by the Assembly. IMO adopts legislation and national governments are responsible for implementing conventions under international treaty law. As LESS-DEVELOPED COUNTRIES (LDCs) became more heavily involved in shipping during the 1970s, they secured a greater representation on the Council. As a relatively small specialized agency, the IMO has a staff of 300 and its total budget for 1998–9 was US\$56 million, paid by member-states in proportion to the size of their merchant fleets.

The limited mandate of the IMO reflects and exemplifies the essentially private character of international shipping – an industry traditionally characterized by extensive transnational

organization and freedom from government regulation. The original hopes that IMO would serve to regulate commercial practices proved to be too ambitious. The IMO Convention required the agreement of twenty-one states (of which seven should possess one million tons of merchant shipping) to be ratified. But ratification was delayed until 1959. Opposition to IMO hinged on the original mandate to investigate charges of discrimination and unfair practices – a condition that shipping conferences and developed countries refused to accept.

Consequently, IMO has functioned largely as a weak regulatory body – the poorest specialized agency within the UN. It is dependent on scientific personnel who are limited to a range of issues that are more technical than political. The key objectives of the IMO are reflected in the slogan 'safer shipping and cleaner oceans'. Despite its accomplishments in the fields of safety and pollution, the IMO operates on the margins of international shipping politics. IMO conventions must be ratified by member-states, which are also responsible for compliance. The principal political economic issues of world shipping are decided through the workings of the marketplace, with its oligopolistic structure (see OLIGOPOLY), and by maritime diplomacy among the major maritime powers.

Among the most important IMO conventions are the Convention on the Safety of Life at Sea (SOLAS Convention), adopted in 1960 and covering a range of measures designed to improve safety. A new SOLAS convention was adopted in 1974 and, since that time, numerous amendments have been implemented. The Torrey Canyon disaster of 1967, in which 120,000 tons of crude oil spilled into the English Channel, led the IMO to adopt the International Convention for the Prevention of Pollution from Ships in 1973.

See also:

flags of convenience (FOCs); shipping

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ALAN CAFRUNY

international markets

Markets exist when there is regularized exchange of goods or services between buyers and sellers. Long-distance markets have existed for some goods for centuries, but many international markets for primary COMMODITIES and manufactures have emerged since the end of the nineteenth century. International markets developed in the post-war period for many goods and services because modern communications and transport made it possible for buyers and sellers living in different countries to effect such exchange. At the limit, the markets for many goods and services – particularly financial products – have become global. The markets for some goods, and to a greater extent services, may be more local. This may be because the goods are very bulky or because the demand is highly specific to particular areas. Certain services, particularly personal services, require the buyer and seller to be in actual physical contact: increasingly, however, SERVICES TRADE can be performed through electronic communication when the buyer and seller are long distances apart.

Major technological advances have reduced TRANSPORT COSTS and improved communications. The progressive lowering of TARIFFS and other NON-TARIFF BARRIERS (NTBs) for most industrial products over the past half-century has contributed towards a marked expansion in

International Monetary Fund (IMF)

the size of the markets and many goods have become increasingly international.

Some international markets – especially for primary commodities – are organized through formal exchanges which turn over large volumes and set benchmark prices (for example, the Rotterdam spot market for oil). For manufactures, though, international markets have primarily emerged in the post-war period through firms exporting to foreign markets and locating overseas production there.

See also:

globalization

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NIGEL GRIMWADE

International Monetary Fund (IMF)

The International Monetary Fund (IMF) is an inter-governmental organization established in 1945 to manage an exchange-rate system conducive to an open world economy. The founding member states of the IMF originally intended the organization to serve as a concomitant to the planned International Trade Organization (ITO). Over time, the scope of the IMF expanded to encompass the oversight of a range of national economic policies having external monetary effects. To help prevent such effects from disrupting trade and international economic growth, its members endowed the IMF with its own financial resources, in the form of quota subscriptions. Members requiring financing, generally to cover short- or medium-term shortfalls in their external payments, are able to draw upon the IMF's resources in proportion to their quotas and under conditions that increase in severity

with the size of the amount being drawn. These conditions typically relate to negotiated adjustments in underlying national policies deemed to be generating the shortfall.

The challenge of designing politically acceptable mechanisms for managing the adjustment of international payments' balances is a fundamental one. When trade (or investment) across national borders occurs, financial claims are generated. In the absence of a global currency to settle such claims – in other words, in the absence of a global government capable of creating the financial liquidity and confidence necessary for smooth adjustment to occur – a modicum of inter-state cooperation and collaboration is necessarily required. During World War II, elites in the Western alliance came to view the lack of such cooperation in the 1930s as an important *casus belli*. Far from serving as lubricants for mutually beneficial international economic exchange, national monies were in retrospect seen as having been manipulated by governments to gain unfair competitive advantages.

Associated theoretical and policy debate came to centre on the 1941 proposal by JOHN MAYNARD KEYNES for an 'international clearing union', an ambitious and more or less automatic mechanism for financing and adjusting inter-state payments' imbalances. Resistance by and within the United States, the expected net creditor in any such arrangements, ultimately ensured that Keynes' idea would be scaled back. The negotiation of the Articles of Agreement of the International Monetary Fund at the United Nations Monetary and Financial Conference, held at Bretton Woods, New Hampshire, from 1 July through to 22 July 1944, nevertheless stands out as a remarkable triumph in the history of liberal MULTILATERALISM. (An agreement to establish the International Bank for Reconstruction and Development, or WORLD BANK, was also crafted at the Bretton Woods meeting.) The articles codified a system of 'pegged' (or fixed but adjustable) exchange rates. The IMF was intended to oversee that system, coax members in the direction of full currency convertibility for current (not capital) transactions and provide supplemental financing when needed

to forestall the adoption of policy measures potentially harmful to a growing international economy.

The IMF came into existence on 27 December 1945. The Board of Governors held its first meeting in Savannah, Georgia, on 8 March 1946, and on 6 May the Executive Board held its inaugural meeting at the new headquarters in Washington, D.C., by no coincidence established a few blocks away from the White House and US Treasury. The Board of Governors, generally comprising finance ministers and central bank governors from all members, continues to meet annually. Since the mid-1970s, two advisory committees drawn from the Board of Governors – one for industrial countries, one for developing countries – meet twice a year. The Executive Board, however, continues to be the central organ in the day-to-day operations of the IMF. The board consists of some two dozen officials from national governments or central banks. Several of these Executive Directors are appointed individually by members with large quotas; all other members are represented through a constituency system, with one executive director elected, often on a rotating basis, by a group of member states. Today, almost all countries in the world are members and are thereby represented on the Executive Board. The board routinely meets three days per week and is chaired by the Managing Director, who is elected for renewable five-year terms. The Managing Director also heads the organization's staff, numbering over 2,000, the majority of whom focus on analysing the economic situations of specific countries and administering IMF programmes of relevance to them. In theory, decisions of the Executive Board are taken through a voting procedure that correlates the weight of directors' votes with national quotas. In practice, most decisions reflect a consensus achieved after detailed discussion by the Executive Board on the basis of the analytical work of the staff in consultation with officials from member states.

Although the IMF initiated its financial operations on 8 May 1947, when France drew upon its resources, the organization did not

turn out to be central to the post-war international order. Partly hampered by the decision of the Soviet Union not to join, it found itself sidelined by US foreign policy during the COLD WAR. It nevertheless began a gradual evolution as its management and key member-states charted a middle course between principled economic aspiration and pragmatic political adaptation. That evolution moved along three interrelated lines, matching the organization's core functions: overseeing national exchange-rate policies, discouraging exchange restrictions and providing a forum for discussions on international monetary matters.

Following a series of currency crises occasioned by attempts to defend the BRETTON WOODS SYSTEM, a new form of international reserve was created in the accounts of the IMF. The First Amendment to the Articles of Agreement, which enables SPECIAL DRAWING RIGHTS (SDRs) to be issued by the IMF, entered into force on 28 July 1969. Fundamental problems remained, however, and in the early 1970s the central provisions of the articles were voided by state practice. In the face of inflationary pressures and divergent national economic policies that mirrored underlying political disputes over the redistribution of adjustment burdens, the United States allowed the exchange value of the dollar – the key currency in the system – to float. A long, frustrating series of inter-state negotiations on reforming the monetary system ensued. In the end, all that proved possible was an agreement to bring the IMF's articles into conformity with the new situation. The Second Amendment nevertheless expanded the formal jurisdiction of the IMF and enjoined it to promote a stable system of exchange rates. Most importantly, the new Article IV obliged all member states, not just those requiring IMF resources as had previously been the case, to consult regularly with the IMF on all economic policies influencing their current accounts. Such consultations, culminating in formal but confidential policy advice rendered by the Executive Board, constitute the core of what is now known as the IMF's multilateral surveillance role. Filling out that role are a

International Monetary Fund (IMF)

series of broadly based and often published assessments of prospects for the world economy, as well as a set of procedures for gathering and publicly disseminating important indicators of national economic conditions. IMF advice is also transmitted directly by the Managing Director in the context, for example, of regular inter-governmental meetings held among the finance ministers of the world's leading industrial countries (see GROUP OF 7 (G-7)).

Since the 1970s, the IMF's surveillance role, together with the gradual expansion of its financial resources through quota increases, specially endowed facilities for specific purposes like the promotion of structural adjustment in developing countries, and emergency credit lines made available by rich members (originally the so-called GROUP OF 10 (G-10), currently expanding) – have put it at the centre of global financial crises. They have also put the organization at the centre of a range of international political controversies over the best way to foster economic growth without ignoring demands for social justice, environmental protection and other policy objectives. In the early 1980s, the IMF proved critical to the management of severe debt-servicing problems then confronting a wide range of developing countries and their private creditors in industrial countries. In the 1990s and into the new century, the organization was prominently engaged in giving general policy-guidance, financing and technical assistance to Russia and other member states making the transition from COMMAND ECONOMIES to market economies, as well as to member states facing difficulties associated with volatile international capital flows and endemic poverty.

Together with other multilateral economic institutions, the IMF has come to symbolize a new global economy. Continuing to mirror the priorities of its leading member states, the IMF actively promotes economic policies aimed at low inflation, increased national openness (now both to trade and investment) and more flexible and competitive internal labour and capital markets. At the dawn of the twenty-first century, increasingly open markets for private

capital provided primary incentives for the adoption of such policies. Attempting to secure and stabilize such markets had therefore become more central to the evolving mission of the IMF. That reality was recognized in a controversial movement to amend the articles again, this time to extend the organization's formal surveillance mandate to cover the capital account of national payments balances.

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integrated capital markets by a former US central banker.

L.W. PAULY

international non-governmental organizations (INGOs)

The UNITED NATIONS (UN) generally defines NON-GOVERNMENTAL ORGANIZATIONS (NGOs) as any non-profit group organized locally, nationally or internationally, whose activities are determined by the will of its members. Today, NGOs are increasingly organized on an international basis. The Union of International Associations defines an international non-governmental organization (INGO) as having these characteristics: an international aim or goal; the solicitation of membership and funds in at least three countries; a formal structure which allows for rotating elections and permanent headquarters, and evidence of current activities.

INGOs can be classified into two categories. The first group are organizations that began as a nationally based NGO and then expanded into other countries. These include organizations like the International Rescue Committee and the International Medical Corps. The second category are organizations that were founded as INGOs and have representatives and/or field organizations in a number of countries. Examples of this category include the World Wildlife Fund (WWF) and the International Federation of Airline Pilots Associations (IFALPA). There are several possible transitional phases for organizations in the first category. In the initial phase, an organization may have a limited number of members doing international work (for example, attending conferences, information sharing, networking). In the second phase, as international operations grow, an organization may allocate specific resources to expand international activity. A third phase, sometimes proceeded to immediately, is the active recruitment of multinational members. In the final stages, an INGO will strive to treat all of its

members and operations around the world equally.

INGOs draw their support from diverse membership that may span several countries. What unites them is the pursuit of common objectives that usually do not conform with national borders. Rapid advances in communications technology have provided tools for information-sharing that could not have been envisioned fifteen years ago. The ability to utilize a variety of organizational structures due to technology allows a great deal of flexibility and has facilitated the growth of INGOs. For instance, it is possible to have international operations with a centralized headquarters or, conversely, to have a highly decentralized and mobile organization. Thus, accelerating GLOBALIZATION, increasing citizens' awareness of transnational issues and new communications tools have all led to the significant growth of INGOs.

The growth of INGOs has been bolstered by significant participation in multilateral forums like the 1992 United Nations Conference on the Environment and Development (UNCED), the 1994 International Conference on Population and Development (ICPD) in Cairo and the various UN conferences on women. Such forums have facilitated networking, information and resource sharing, and global platforms for like-minded organizations around the world. It has been suggested that INGOs represent a growing third force in INTERNATIONAL RELATIONS (IR), running parallel with the growth in international governmental organizations (IGOs) in the political sphere and the globalization of business in the economic sphere.

INGOs are becoming an essential part of public life at various levels throughout the world and the UN has long recognized the importance of INGO participation. All of the UN specialized agencies (except the Universal Postal Union and the financial group) enter into consultative agreements with INGOs. For example, Article 71 of the UN Charter authorized the ECONOMIC AND SOCIAL COUNCIL (ECOSOC) to grant NGOs (including INGOs) consultative status. More than 800

international non-governmental organizations (INGOs)

NGOs, many of them internationally organized, have consultative status with ECOSOC today and are organized into several areas that deal with diverse issues. These include, among others, human rights, SUSTAINABLE DEVELOPMENT, population, trade, INVESTMENT and entrepreneurship, the status of women, and issues concerning indigenous people. Specifically, an INGO like the International Committee of the Red Cross provides 20,000 tons of food a month and runs more than 800 kitchens worldwide for over a million people. The International Federation of the Red Cross and Doctors Without Frontiers deliver humanitarian aid, in conjunction with many UN relief missions, and often go to areas that the UN cannot get into.

The growth of INGOs and their influence on the world stage in recent times is noteworthy. IGOs such as the UN or the WORLD TRADE ORGANIZATION (WTO), which are formally established by NATION-STATES, have grown more modestly. For instance, from 1993-4 there were almost 5,000 active INGOs compared to 272 IGOs. There were also more than 3,600 active national NGOs with an international focus. This data is consistent with Figure 6 below, which tracks the growth of NGOs and IGOs over a 100-year period.

INGOs influence both domestic and international policies. For example, Amnesty International has been central to the expanded effort to promote human rights abroad. Amnesty

International promotes, through lobbying, agenda-setting, monitoring and consciousness-raising, its own single-issue concerns. It answers to a global constituency of members concerned about similar violations. While organizations like the UN are bound by the considerations of sovereign states, INGOs like Amnesty International are often free of such constraints. In this way, INGOs can sometimes bring more weight to bear on issues like human rights than like-minded IGOs or states.

The growing influence of INGOs has the potential to erode the responsibilities for which state governments have traditionally been held accountable. INGOs introduce yet another player to an already crowded international stage. Decision-making by consensus, a value held in common by many INGOs, becomes problematic as the number of international actors proliferates. The Earth Summit in Rio de Janeiro (and the parallel Global Forum) and the Population Conference in Cairo were notable for the thousands who participated in the NGO-sponsored sessions. Though the groups participating wanted to influence the official conference through citizen-based lobbying and action plans, the multiplicity of agendas and interests interfered with the possibility of a coherent outcome. Like states, INGOs have their own interests that must, at times, be protected to the detriment of someone else. Moreover, INGOs must ask who their target constituency is and rationalize that with

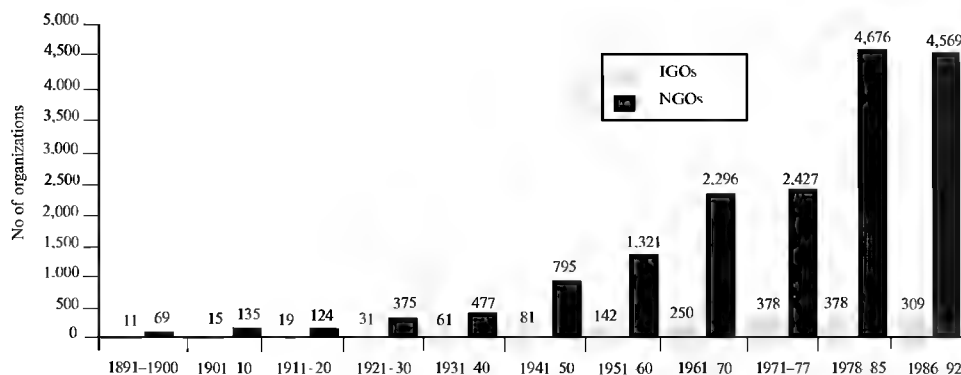


Figure 6 Growth patterns of IGOs and NGOs (1891-1992)

Source: Mingst and Karns, 1995: Figure 1.1

the interests and activities of their active members.

INGOs, in the final analysis, represent a modern and proliferating presence on the international stage. Increasingly, these organizations will be created as global entities rather than national ones, and the NGOs that remain national will increase their international operations and activities.

See also:

global warming (UN Climate Convention)

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DAVID J. MUDDLE
GILBERT R. WINHAM

International Organization for Migration (IOM)

The International Organization for Migration (IOM) was founded in 1951 as the Provisional Intergovernmental Committee for the Movement of Migrants from Europe. Its task was to assist in the resettlement of displaced persons in post-World War II Europe. Reflecting its increased involvement outside Europe, its constitution was updated in 1987 to reflect its global activities and it was given its current name.

The IOM's main activity is to provide practical assistance in the evacuation and resettlement of individuals caught in crisis situations, usually in collaboration with other international organizations. Thus, the IOM assisted in the resettlement of over one million refugees from Indochina, the repatriation of more than 200,000 people caught in the midst of the GULF WAR and the assistance to hundreds of thousands of people displaced by the war in the former Yugoslavia.

The IOM has also initiated programmes promoting and facilitating the return of migrants and exiles to their home countries.

HENK OVERBEEK

International Organization of Securities Commissions (IOSCO)

The International Organization of Securities Commissions (IOSCO), based in Montreal, is the primary international organization for promoting international collaboration among securities regulators. It was founded in 1974 as an inter-American association, and adopted its present name and global mandate in 1984. It

international organizations (IOs)

conducts studies and discussions, develops agreed principles, has promoted a series of memoranda of understanding that aim to fight cross-border securities fraud and has sponsored efforts to negotiate CAPITAL ADEQUACY STANDARDS for SECURITIES firms. It has more than ninety members from sixty countries, mostly state regulators but also self-regulatory organizations and international organizations.

TONY PORTER

international organizations (IOs)

This article first develops a set of typological constructs to define and distinguish various forms of international organizations (IOs). It then touches on the evolutionary development of the study of IOs as a field.

For some scholars and practitioners, the term 'international organizations' refers strictly to organizations created by agreements between states. For others it may also refer to agreements between public and private actors that deal with each other across boundaries. IOs can thus be distinguished from international governmental organizations (IGOs), which are established by the duly designated representatives of governments, and INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs), which are concluded between societal actors.

Following Harold Jacobson, one may further distinguish IOs along the two dimensions of membership and functions. Organizations can be inclusive and open to new entrants or they can be restrictive and limited in membership. Multilateral organizations are examples of the former, regional organizations an example of the latter. The Organization of American States, for example, logically excludes European states. One may also distinguish organizations with specific functions from general-purpose organizations. Thus, the World Health Organization is specific in focus, compared to the general functions of the UNITED NATIONS (UN).

The study of IOs has gone through several evolutionary modifications. Starting with a

relatively precise (if formalistic) notion of 'organization', the international relations field has moved to a less formal and epistemologically interpretivist view. In the first phase of the study of organizations, the analytic focus was largely on the formal aspects of the institutions. Organizations were thus materially represented in buildings, personnel and mandates with specific task-descriptions. In order to understand what the organization did and what effects it was likely to have, one would study the charter of the organization, its resources and so on.

In a subsequent phase, it became manifestly apparent that the formal charters, voting procedures – in other words, the materialist underpinnings of the organizations – provided little insight into the actual tasks of or the real decision-making procedures in those organizations. The United Nations, for example, in the 1960s and 1970s was less driven by formal mandates and its charter provisions than by great power calculations, the North/South divide, demands by the GROUP OF 77 and so on. Consequently, one turned the analytic focus to a study of voting patterns and alliance behaviour within those institutions.

Finally, organizations have come to stand for international governance in general. The study of IOs has come to encompass the study of basic rules of international conduct and has branched out to the analysis of regimes, the latter denoting formal rules and procedures in international agreements, but also less formal norms and principles. The presence of the latter, in particular requires the student of IOs to depart from the objectivist epistemological stance, implicit in the earlier study of international organizations, in favour of a more interpretivist epistemology. Whether or not the participants in international regimes are really abiding by the norms and principles of those regimes can only be answered by an analysis of the participants' perceptions and interpretations of what the norm entailed.

Further reading

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HENDRIK SPRUYT

international political economy (IPE)

International political economy (IPE) addresses the complex interrelationship between political and economic activity at the level of

international relations (IR). Such complexities, however, prevent any simple account of the subject. In particular, IPE confronts controversies over the relationship between politics and economics and disputes over the centrality of 'international' relations (or more properly inter-state relations) within world affairs. This, in turn, raises questions about the most important realms of political economy: a discrete domestic level or an international level that seeks to accommodate, and ultimately encompass, the domestic domain.

The atrophy of political economy

The term 'political economy' is as old as the systematic study of economics and of the economic aspects of public policy. The classical economists – ADAM SMITH, JOHN STUART MILL, DAVID RICARDO, and such radical followers as KARL MARX – were all political economists in the traditional sense of seeking to develop a body of fruitful ideas for the guidance of policy-making by political authorities or their opponents. The earliest university departments devoted to the study of economics were thus entitled 'departments of political economy'. The progressive professionalization of the discipline of economics and the formalization of its more advanced theoretical ideas, however, distanced traditional political economy – with the partial exception of work in such areas as development studies – from many of its direct policy concerns and from the other emergent social sciences which had a more direct focus on the workings of political systems and their policy-making processes and products. Political economy has, in a sense, fragmented into economics and politics, with few points of intellectual contact and communication.

The 'political economy' that remains within 'mainstream' professional economic study and analysis is thus a policy-orientated enterprise. It is concerned with those aspects of economic theory and knowledge that are, or may be, pertinent to the shaping of public policy. It focuses on such questions as the likely effects on the domestic economy of a change in

interest rates or levels of taxation, or the effects on international trade of the imposition of tariffs or the deployment of subsidies. Such a *policy-orientated* political economy stands in sharp contrast to the *structural* (or fundamental) political economy, which is of interest to many of those working within the resurgent discipline of political economy during the third quarter of the twentieth century, and which focuses on more fundamental questions of the political economic interrelationship.

An active concern with the interconnections between the 'economic' and the 'political', however, was not entirely submerged by the emergence of institutionalized economic science. Many of those who retained an intellectual interest in the basic driving forces of human history, maintained a clear view of the central and interrelated roles of both economic and political factors. An influential group of political economists who maintained such a perspective, sought to preserve the LAISSEZ-FAIRE system from a variety of threats: whether from suppression by overbearing states or unsympathetic politics (in the case of FRIEDRICH VON HAYEK or Ludwig von Mises), or from the adverse consequences of its own processes (as in the case of JOSEPH SCHUMPETER).

Advocates with a more direct interest in radical politics also preserved a vigorous interest in the economic-political interface. Political critics of modern capitalism thus developed and advocated a powerful, critical political economy. Marxists, non-Marxist socialists and liberal anti-imperialists (like J.A. HOBSON) thus all contributed to an evolving radical political economy that exerted considerable popular appeal and influence during the nineteenth and early twentieth centuries.

The revival of political economy

The advent of the post-1946 COLD WAR between the communist bloc and the anti-communist Western Alliance had a profound influence on the fate of political economy. The particular emphasis given to the economic dimension in human affairs by Marxism (see MARXISM-Leninism) led many in the West to

identify any and all forms of political economy with Marxism and, hence, with the ideology of the 'communist' enemy within the Cold War confrontation. Moreover, the widespread adoption of Keynesian approaches to economic policy throughout the industrialized world seemed to have resolved the problems of macro-economic management, and of the pursuit of economic stability. Keynesianism thus furnished an apparent resolution to any tensions between economics and politics in principle and practice within liberal democratic societies (see KEYNESIAN ECONOMICS).

Outside Marxist and neo-Marxist circles, political economy was thus forced into virtual abeyance within Western intellectual and academic circles during the 1950s and 1960s with a few notable exceptions: a distinct, yet diverse, non-Marxist group of analysts continued to seek an understanding of the dramatic political and economic upheavals of the first half of the twentieth century, particularly Schumpeter, KARL POLANYI and ALBERT O. HIRSCHMAN.

Joseph Schumpeter, writing in the aftermath of the Great Depression of the 1930s, sought a non-Marxist interpretation of the political and social effects of a dynamic, capitalist economic system. Under the influence of the 'waves of creative destruction' that were characteristic of the dynamic of the capitalist system, popular reactions would be borne that were hostile to that system and, hence, conducive to its restraint or even partial suppression. Karl Polanyi was equally concerned to explore the destabilizing effects of a dynamic free-enterprise system. The destruction of traditional social structures and traditional sources of human support under the remorseless advance of the market system spawned a general quest for a renewed sense of security and identity that was all too responsive to the extremist agendas of a succession of authoritarian, and ultimately xenophobic, political movements and regimes throughout the first half of the twentieth century.

Alfred Hirschman was concerned primarily with the political causes of economic patterns, rather than the political consequences of economic developments. He thus set out to

explore the complex interrelationships between economic and strategic concerns in the external relations of the developing Nazi regime of Germany during the years immediately preceding the outbreak of World War II. In the evolving pattern of its relations with its immediate neighbours in Central and Eastern Europe, Germany exhibited an extreme form of MERCANTILISM, in which the generation of the economic dependence of its neighbours served both the economic and ultimate political ambitions of Hitler's aggressive regime. The general salience of this study lay in the highlighting of the role of political purposes in shaping economic relationships and generating longer-term dynamics within the political and economic realms.

The early years of the Cold War were also the era of DECOLONIZATION. The new political independence of so many societies that had previously been under the direct control of Western (and largely European) colonial states, prompted a rapid and substantial increase in interest in the political economy of development. A combination of circumstances and prevailing intellectual currents ensured that both the role of political authorities and the influence of the wider international economy would feature prominently in many approaches to DEVELOPMENT. The political economy of development was thus, from an early stage, a field of analytical interest that combined international political economy with domestic political economy, challenging a simplistic division that would sometimes arise within political economy.

A distinctive slant on political economy was also sustained by those (largely within the United States) whose work reflected the continuing influence of THORSTEIN VEBLEN. This institutionalist tradition emphasized the role and effect of a variety of social, economic and political arrangements which emerged over time and shaped the patterns of economic activity within any society (see INSTITUTIONALISM). The initial focus of such institutionalists was primarily domestic. However, the international implications of the approach were all too clear, particularly to analysts working

within the economy that was to dominate the post-1945 world and which would spawn the lion's share of that most salient of post-war economic institutions: the multinational or transnational corporation (see MULTINATIONAL CORPORATIONS (MNCs)).

By the early 1970s, however, a number of developments within the political and economic realms prompted a more widespread revival in non-Marxist political economy within Western intellectual circles. In the political domain, there were also early signs of a possible détente between the West and the communist bloc: President Richard Nixon and Secretary of State Henry Kissinger had initiated a major diplomatic opening towards China; the United States had begun to disentangle itself from Vietnam, and the ferocity of the confrontation with the Soviet Union had begun to wane.

Equally significantly, the post-World War II economic recovery had borne fruit throughout the industrialized world. Europe had recovered, with Germany regaining a powerful position in the international trade system. Japan had revived spectacularly and was now impacting with increasing force on a range of international markets. Increasing competition in world markets and, indeed, in formerly secure domestic markets, added their effects to the growing balance of payments burdens suffered by the United States to force, in 1971, the country's abandonment of dollar convertibility into gold: a development of deep symbolic significance for the United States and the post-war world economic order.

General growth in the world economy throughout the 1960s and early 1970s had, moreover, generated an ever greater demand for raw materials and the primary products that were traditionally exported by the LESS DEVELOPED COUNTRIES (LDCs). The prices for all commodities were rising significantly and none more so than the prices for oil. In 1973, the Arab members of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) responded to the outbreak of war between Israel and its Arab neighbours to impose selective oil supply embargoes and a general

international political economy (IPE)

restriction of volumes of oil exports, aimed at securing a substantial increase in world oil prices.

The world was thus beginning to appear to be a far more complicated place by the early 1970s than it had when the simple polarities of the Cold War had predominated. The political and military supremacy of the United States had been challenged by its experiences in Vietnam. Its economic preponderance also seemed to be under challenge: economic competition cross-cut Cold War alliances, and the LDCs, emboldened by rising prices for their primary exports, were beginning to demand a New International Economic Order that would, in their view, better serve their needs and interests. The combined effect of such diverse, but critical, developments was to refocus the attention of many observers from issues of politico-military security and high strategy towards the complexities of the evolving IPE. The vigorous revival of political economy, and particularly international political economy, was both 'permissible' and desirable in the face of such developments in world affairs, particularly within the United States.

The three basic varieties of political economy

The conditions that prompted the revival of political economy in general, and of international political economy in particular, did not, however, dictate the form or content of the political economy that would emerge. Diversity of purpose and perspective thus characterized the resurgent subdiscipline of IPE.

Three contrasting views of the relationship between the 'economic' and the 'political' can be identified within contemporary political economy. The first emphasizes the primacy of the economic realm in shaping and driving the political and social aspects of life. The second identifies politics, political interests and political power as the most fundamental influences on long-term economic and social developments. The third emphasizes the continuing, dynamic interrelationship between the 'economic' and the 'political', and seeks to identify the complex and varying interconnections that

characterize the central developments and departures in human history.

The primacy of economics

THE HISTORICAL MATERIALISM of classical Marxism emphasized the fundamental role of the economic infrastructure of any social and political system. The economic infrastructure underpinned the superstructure of ideas and institutions in the social and political realm. The driving force of change and development in human affairs also resided within the infrastructure and in the generation of opposing interests, clashing political and economic forces, partially resolved in the next, 'higher' stage of human development: the dialectical process that Karl Marx borrowed, and inverted, from the philosopher Hegel.

As classical Marxism-Leninism has waned in its practical influence and intellectual appeal, a range of neo-Marxist perspectives has emerged and flourished (see NEO-MARXISM). DEPENDENCY THEORY has proved to be one of the most influential forms of late twentieth-century neo-Marxism, with its emphasis on the structural damage to the economies of many of the LDCs from formal and informal control by the capitalist-industrial economies during the past two to three centuries. The economic, social and political systems of the LDCs have thus, according to dependency views, been distorted by the influence and interests of the dominant enterprises of the industrialized (or industrializing) world, and left in a condition that inhibits genuine and sustainable development – economic, social and political. An avenue of escape is offered by dependency theorists, however, through determined political action to transform conditions domestically and to promote collective radical action internationally, thereby escaping the dependency relationship with the rich, industrial capitalist world.

The dominance of politics

In direct contrast with the historical materialism of classical Marxism, or the undifferentiated

radicalism of the dependency approach, stands the tradition of realist and mercantilist thought. REALISM within IR has traditionally been identified primarily with the arenas of 'high policy': security, diplomacy and power politics. The application of realism to the economic realm, however, emphasizes the role that political power plays in shaping the context within which economic activity takes place.

The central role of politics for economic life is demonstrated by cases where effective government is absent or, worse, where political actors play a destructive role in the economy. Where political authority does not underpin the economy, with a supportive system of LAW, extended economic activity, across time or space, is either impossible or possible on the basis of considerable (and highly costly) efforts to provide private substitutes for the services that a more effective political system would have supplied. Maritime trade during times of extensive piracy in the past required complex convoying systems and the provision of armed protection by the private owners of ships themselves. Where, under even worse circumstances, political power is deployed in a destructive or predatory manner, economic life is often reduced to subsistence levels, or even lower, as was seen in some African economies during the late 1990s and early 2000s.

Elaborate patterns of productive activity, exchange and development, thus require the shaping of a stable and reliable context by political authorities. The tasks of such political authorities range from the suppression of banditry and piracy, through the maintenance of a reliable currency and enforceable contracts, to the REGULATION of business in many fields of endeavour of interest to the general public.

Pressed further, the realist approach extends to the argument that the development of any elaborated economic system requires shaping and underpinning by the political system within which it develops.

In policy terms, the realist approach commends measures to ensure a stable and supportive framework of laws, regulations and

institutions within which economic life can function and flourish. Such a framework will be equally important for a well-functioning domestic economy or a stable and beneficial international economy. A realist disposition can, however, readily move into a more assertive mode. Under mercantilism, political authorities are enjoined to use political power and authority to shape economic activity to ends identified by, or for, those political authorities. Economic activity is now intentionally subordinated to political purposes: the interests of the ruling princes in classical mercantilism; the general well-being (economically, socially and politically) of the population in NEO-MERCANTILISM.

The period of the emergence of the modern system of states was also a period of active mercantilism. Initially, princes and other rulers sought to direct the economic activity of their societies to the support of their political and military purposes. Productive activity was regulated to ensure that necessary goods would be produced in sufficient quantity and quality and, most importantly, taxed to provide the rulers with the financial resources for their armies and navies. Trade was equally viewed as a source of taxes and as a means of generating a favourable balance of dependencies with potentially hostile foreign states.

The later expansion of the concerns of states and their rulers, merely expanded the purposes to which mercantilist policies could be directed. A vigorous domestic industry, prosperous traders, wealthy financiers and advantageous overseas possessions, all entered the list of objectives to which the energies of the state would be directed, policies shaped and, if necessary, war undertaken. Explicit mercantilism, however, came under increasing attack as the new doctrines of economic LIBERALISM began to emerge and attract attention in the eighteenth century.

Obliquely related to the realist approach are the institutionalist and evolutionary perspectives on political economy. Here, again, there are doubts about the self-generating and self-ordering capacities of economic systems. Rather, all economic systems are seen to be a

function of the socially defined aspirations and expectations of their individual members, to have been shaped by the institutional arrangements that have emerged historically, and to be subject to regulation by a range of authorities – both public and private – that have been constructed over time. Institutions, including political institutions, thus remain fundamental to the functioning of any given economic system and may well be the original source of specific economic systems, including complex market economies.

The complex interrelationship of politics and economics

Many contemporary students of political economy, however, remain reluctant to ascribe automatic primacy to either the economic domain or the political realm in the relationship between economics and politics, past and present. Advocates of a close interrelationship between the economic and the political range from liberal political economists who identify a profound interconnection between the functioning of the economic and the political systems, through to students who seek to uncover long-term worldwide waves of economic activity and cycles of political change. Such work does not require elaborate theoretical foundations, merely the expectation that there is likely to be a complex interrelationship between the political (broadly defined to encompass military and security issues) and the economic. Some such approaches are, however, explicitly and strongly theoretical in their purposes and presuppositions.

The advocacy of minimal governmental intervention in economic life by liberals reflects, not a belief that the two domains have no significance for one another, but rather that their mutual significance is actually critical. For liberals, the freedom to pursue economic interests and well-being is threatened by a government that seeks, and is able, to interfere substantially in the economy: the extreme cases being those of feudal tutelage or the overweening role of government in a communist state. Equally, however, a truly democratic system of

politics can, in the liberal's view, only rest on a diffusion of ownership within the economy and a diversity of employment opportunities. In the absence of such a dispersed economic system, the concentration of economic power and influence would undermine the real capacity of all individuals to exercise their democratic rights and freedoms in a manner consistent with the principles of liberal democracy. For liberals, however, the free-market economic system will be more-or-less self-sustaining if government establishes the minimal conditions for stable economic activity and, in all other respects, steps back from the economic realm. The spectacular economic development of a number of relatively undemocratic societies in South-East Asia during the late twentieth century, however, threw serious doubts on the simple economic-political equation of the traditional 'liberal' view.

For the more extreme of liberals, however, the free market would flourish, and would perhaps only flourish fully, if government was dissolved and a new nirvana of rational, self-interested individuals were freed to determine their own behaviour, leaving the collective good to be generated by the INVISIBLE HAND of the unrestricted market. While liberals, of various persuasions, thus pinpoint a critical interrelationship between the political and the economy, they are generally far happier about the economic domain being given free rein, while the political is constrained or even diminished: the 'invisible hand' that ensures optimal outcomes within the economic arena is not identified, with equal confidence, within the spheres of politics and collective policy-making.

A complex perspective thus emerged from 'liberal' foundations: a free economy was essential to a democratic political system and vice versa. The traditional 'liberal perspective' was then further developed into the international sphere and generated a number of central propositions: that free trade would generate a condition of benign international economic interdependence that would end inter-societal conflicts and war; and that democracies, in particular, would not seek to make war against other societies and, in

particular, plunge into armed conflict with other democracies. The theory of benign interdependence achieved particular popularity on the eve of World War I. The democratic-peace tradition was revived and popularized by President Woodrow Wilson during the efforts to stabilize peace after the end of World War I. Its presumptions remain under intense debate to the present day.

The province of regime theory

A distinct, and highly productive, approach to IPE also emerged from a broadly liberal basis during the revival of the subject in the 1970s. 'Liberal institutionalism', as it has become known (sometimes entitled NEO-LIBERALISM, thereby engendering confusion with the more extreme pro-market, anti-interventionist economic policies of the 1980s and 1990s that were also termed 'neo-liberalism'), accepts the general desirability of a free-trade system and the role of rational, self-interested behaviour. However, the rational and self-interested actors that operate within the international arena are not true individuals, but composite actors like states, large business enterprises or interest groups. Problems of effective COLLECTIVE ACTION in pursuit of mutual advantages (COLLECTIVE GOODS) are also particularly acute on the international stage. Such collective action – honouring the principles of free trade, conforming to generally agreed rules and regulations, accepting mutual restraints in areas like environmental protection and preservation – encounter difficulties which, if unresolved, would produce sub-optimal outcomes for both the world community and the individual actors involved.

Liberal institutionalist IPE has thus come to identify international regimes as central to the durable resolution of the problems of effective collective international action. Such regimes – sets of common norms and expectations of behaviour within the relevant policy area – can be imposed, and sustained, by hegemons (see HEGEMONY): developed by small groups of influential, like-minded actors; or, even, agreed from the outset by all the parties to the

potential regime. Regimes can, moreover, vary considerably in their level of formalization – in written agreements and/or concrete institutions. The central point about such regimes, however, is the answer that they provide to the problems of collective action and the way in which they alter the cost-benefit calculations that involved actors subsequently make when determining future behaviour.

Enter rational choice

A further development of broadly 'liberal' intellectual presuppositions has assumed the guise of a formal approach to IPE which extends restrictive notions of RATIONAL CHOICE and behaviour into the realms of policy-orientated political economy.

Within domestic political economy, the rational choice reduces all social systems, and composite actors, to their individual members. Such individuals are rational, self-interested actors (as in domestic neo-liberalism) who seek to maximize personal utilities in all spheres of activity. Decisions in politics and public policy are thus seen to be no more than the calculus of individual interests and of the relative influence of those interest-bearing individuals.

Translated to the international (inter-state) plane, the rational choice approach to IPE becomes a little more complex. The interests of composite actors, such as states, may be variable in their origins: they may merely reflect the calculus of domestic interests and influence, as suggested by some studies of the origins of protectionist policies; they may reflect the general interests of the state – or the broad society – as emphasized in some inter-governmentalism interpretations of inter-state negotiations and agreements; or they may seem to be a complex response to a complex of internal interests, current state commitments and established international constraints, as indicated in the work of some regime analysts.

The rational choice approach to IPE, despite its clear 'liberal' foundations, in different hands and in different applications may thus evolve into either a liberal institutionalist mode or

assume a neo-realist complexion (see NEO-REALISM).

The structuralist and dependency critiques

Far less sanguine about the operations and consequences of the worldwide free market are those critics of North–South economic relations who have been associated with the work of RAUL PREBISCH – the so-called ‘structuralists’ (see STRUCTURALISM). This critical view of global economic relations owes something to Marxist ideas, but abandons their deterministic features and a number of central theoretical assumptions (the LABOUR THEORY OF VALUE, the law of the declining rate of profit and so on). The core problem for the LDCs was thought (by Prebisch and his followers) to reside in the tendency for the TERMS OF TRADE (the ratio of the unit prices of exports to the unit prices of imports) of the LDCs to deteriorate over time: a proposition that has been much disputed by recent research. The structural conditions underlying the supposed tendency for the LDCs’ terms of trade to decline were, in turn, the differing market conditions facing the characteristic products of the advanced industrial countries and those of the LDCs, and the contrasting internal conditions of employment within both broad categories of societies.

Dependency theorists, with closer (and even more controversial) links to earlier Marxist theories, attributed the current fate of many of the LDCs to the historical impact of the advanced industrial economies through formal IMPERIALISM, the informal penetration of their transnational corporations (TNCs) and the consequential asymmetries within the global political economy. Imperialism, both formal and informal, subordinated the development of the ‘underdeveloped’ economy to the needs and interests of advanced capitalist countries and their international corporations. Moreover, the domestic economic, social and political structures of the dependent economies were also distorted to a degree that inhibited their prospects of balanced future economic development.

The current condition of the LDCs, for both structuralists and dependency theorists, is thus a function of the economic impact of the advanced industrial countries, sometimes reinforced by political control, but that impact has been expressed through economic and political effects within the LDCs. Should, however, political authorities seize the opportunities for individual and collective action that are open to them, then many of their structural disadvantages can be countered and ultimately overcome. Political action is thus not wholly determined by economic forces, and economic conditions are amenable to alteration through political processes.

A radical political economy of such non-deterministic flavour has, moreover, found powerful theoretical support from the re-discovery of the theoretical insights of PIERO SRAFFA, whose distinctive critique of the approach of NEO-CLASSICAL ECONOMICS to questions of value and of the relative rewards of capital, labour and other factors of production provided a powerful alternative to the widely disputed Marxian doctrines of economic determinism in general and of the labour theory of value in particular. In contrast to doctrinaire Marxism, SRAFFIAN ECONOMICS identified historically rooted conditions as the decisive sources of the general relationship between labour and capital within any economy (and their relative rewards) and of that economy’s general relationship with the wider world economy.

Waves and world systems

A distinct approach to IPE can be identified in the work of those who mine the long span of history to identify basic patterns of political and economic life and, most significantly, their interrelationship. Such analysts conventionally study systems of states or state-like actors. Some such systems have been regional; others have been identified as worldwide in scope, or at least in effect. Leading actors rise and fall in power and influence within the system. Economic activity waxes and wanes across the whole system. Increasingly, connections have

been identified between the movement of cycles of political leadership and influence (often dubbed 'hegemony') and patterns of economic growth, technical innovation and inflation within inter-state (or earlier) systems.

The coming of global political economy

Recent developments within world affairs have also raised increasing doubts about the centrality and durability of the international, or inter-state, dimension of political economy. The idea that the world political economy is experiencing a dramatic, unprecedented and ultimately irreversible process of GLOBALIZATION throws the traditional notion of an international, or inter-state, political economy into increasing doubt. Globalization theory has a number of strands, but all highlight factors and processes that dilute the traditional primacy of the state in the world political economy. Liberal globalization theorists emphasize the impact of the increasingly integrated world market in financial services and manufactured goods. Technological globalization theorists stress the central role of the new technologies of information-gathering, -processing and -communication, combined with major advances in the speed and ease of physical travel, in facilitating and even driving the progressive integration of international markets and the emergence of new global social associations and identities. Space and time, for the human beings who inhabit the globalizing world, are becoming progressively compressed.

Critical globalization theorists also acknowledge the impact of the market and of new technologies, but believe that their impact on effective governance is likely to be destructive and their impact on the well-being of the majority of the populations of industrialized and developing countries alike ultimately disastrous. The common strands for all theorists of globalization are thus the remorselessness of market integration, globally; the ubiquitous effects of new technologies and, in consequence, the diminishing role for (or effectiveness of) established political authorities. The

state is thus under pressure in the eyes of all globalization theorists and is in danger of dissolving as an effective actor within an economy that will no longer be truly international, or inter-state, but global.

Globalization's challenge to the centrality of the state in world affairs has echoes of earlier scepticism about the nature and role of the state. Classical Marxism propounded the view that states operated primarily in the interests of the dominant class: of the property-owning bourgeoisie in the case of the modern capitalist state. Other, less extreme views, also downgraded the role of the state in human development: some seeing the progressive achievement of enlightenment as the driving force of human affairs; others identifying an imperative of technological innovation and application as the core determinant of central developments.

Increasing globalization is not, however, the only path for the world political economy in the future. The prospects for increasing regionalization are also considered seriously by many students of IPE. Regionalization also offers a further, but rather more complicated, alternative to the persistence of a state-dominated world order.

The empirical evidence for the growth of regionalization within the IPE is mixed. Regionalization within Western Europe has progressed far further than elsewhere. It is reflected in the high level of intra-regional trade between the economies of Western Europe and in the advance of the institutions of the EUROPEAN UNION (EU). The picture outside Western Europe is, however, far more mixed, with lower levels of intra-regional trade and far weaker institutions of regional association.

Two particularly acute controversies have arisen over the nature and prospects of regionalization within the world system. The first concerns the possible state-like nature of the EU. If, as some believe, the EU is a kind of super-state in the making, then the world of the future might be dominated by a relatively small number of such super-states: a realist world of states still, but at a higher level of power and potential influence. Entities like the EU could, however, fail to build into anything more

substantial than clubs of states and hence preserve the statist order or, alternatively, be mere stepping stages to a new world order: a global state or a relatively depoliticized global community.

The second issue concerns the forces that may be driving integration within the EU and, hence, may eventually come to drive regional integration elsewhere. The determinism/voluntarism debate (which will be discussed later in this entry) arises here. Many approaches to regional (or indeed global integration) refer to the influence of functionalist forces: the pressure for further integration exerted by a range of conditions and requirements, often within the economic realm. Such FUNCTIONALISM smacks seriously of the kind of determinism that itself raises serious philosophical and methodological questions. The more voluntaristic approaches to integration and hence to regionalization, however, leave the prospects for such patterns of development in considerable uncertainty and vulnerable to a wide range of social and political influences and disruptions, including those arising from the established state system.

Underlying issues

The complexities and controversies within IPE indicate the range of philosophical and methodological issues that are inherent to the subject. These issues, and their salience, are not always clear to the practitioners of all of the major approaches to IPE.

DETERMINISM haunts IPE like a spectre at a family feast. The idea that important developments necessarily follow from, or are driven simply and directly by, a relatively simple set of basic factors or forces is far more common within political economy in general, and international political economy in particular, than is often supposed. Classical Marxism-Leninism avowed determinism explicitly (although some latter-day 'Marxists' have sought to deny the deterministic aspects of Karl Marx's own work). Developments in the social and political superstructure of societies were conditioned by developments within the

economic infrastructure: the workings of the prevailing mode of production and the clash of contrasting economic interests and groupings to which that mode of production gave rise. Intellectual doubts about such a mechanical view of human progress were, however, encouraged by a disobliging historical record, and such deterministic elements came under increasing challenge and dilution in surviving variants of the Marxist approach.

Echoes of determinism are also to be detected within a number of views about the recent advance of globalization within the world political economy. Two, often related, forms of determinism surface here. The first is a specific form of technological determinism in which the widespread application of some technological innovations is held to be all but irresistible, and to have predictable and unavoidable consequences. Such technological determinism is often complemented by a wider, though more diffuse, form of (non-Marxist) economic determinism in which a few prominent features of contemporary economic developments are emphasized and held to have irresistible (at least at acceptable costs) consequences for the further development of the global political economy: the further advance of financial integration, the further internationalization of production, the continued erosion of the economic power of states, the further homogenization of worldwide consumer tastes and goods.

The new political economy of hegemonic cycles and long waves also flirts with incipient determinism. The expectation that there might be, or should be, recurrent patterns in human affairs has a deterministic taint, particularly so when those patterns are thought to exhibit temporal regularity. Where a regular causal connection is sought between one or more of the observed patterns, then determinism lurks ever more menacingly. The deterministic trap can, however, be evaded if the identification of any recurrent patterns is accompanied, as in the better scholarship, by a thoroughgoing exploration of the complex interrelationships between the various components of the observed cycles and waves.

A mechanistic view of human affairs is not the only shortcoming of deterministic approaches. They also tend strongly towards reductionism, with explanations of human developments tending to reduce to one (or at best a very small number of) central cause(s): class conflict, technological imperatives, climate change, human nature or whatever. Such reductionist explanations are inherently simplistic: purchasing immediate appeal and accessibility at the expense of the complex range of factors and forces that can lie at the heart of most important developments in human affairs.

Voluntarism is the opposite to determinism within studies of human behaviour, in its emphasis on the role of human self-determination – of the role of consciousness and choice in shaping personal behaviour and, thence, of developments in politics and economics. Here too, however, there are dangers – for extreme voluntarism can lead to the extremities of philosophical idealism or the methodological dead-end of POST-MODERNISM. Moreover, extreme voluntarism can also be reductionist in attributing all central developments to accident or idiosyncrasy, both of which obviate systematic explanation and thereby cumulative progress in the understanding of human affairs. The task, then, is to establish the possibilities for (and limitations on) freedom of manoeuvre and impact on general developments of the individual acting alone or in concert with others.

Structures versus agents; objects versus subjects

The tension between determinism and voluntarism leads into the structure–agent issue within social science, in general, and in IPE, in particular. The simple determinism/voluntarism dichotomy is avoided in the structure–agent debate, however, as attention shifts to the sources and limits of individual actions, on one hand, and the composition and consequence of structures – the complex human aggregations of social, economic and political – for individual and collective life, on the other. The

structure agent debate, moreover, arises within two distinct intellectual traditions: one that emphasizes the objective (that is, enduring and given) character of the human condition, and the other that stresses the central role of human consciousness and of subjectively generated understandings, expectations and impulses. The parallel structure–agent dilemmas can be depicted in the matrix shown as Figure 7.

The issue here is crucial for political economy at all levels, for it raises the central question of the nature of collectivities within human life. Are collectivities – groups, societies, political systems, economies and international systems – really anything more than mere contingent aggregations of all those individuals, or do they have a more enduring and profound existence?

Such intellectual dilemmas have prompted many attempted answers, including that – on the subjective (or cognitive) side of the ontological divide – of STRUCTURATION theory (as popularized by sociologists like Anthony Giddens). This theory adopts a primarily subjective approach to the human condition and argues that structures – or human collectivities and aggregations – do endure and have an effect on their members, but such structures and the individuals who inhabit them are mutually constitutive of one another: the beliefs and actions of individuals are shaped by the structures within which they operate but, by their beliefs and actions, individuals collectively create or recreate the very structures that influence them.

Structuration theory thus appears to finesse the structure–agent problem neatly within the subjective domain of theory. Change in human affairs unfortunately confronts structuration

	Objective	Subjective
Structure		
Agent (actor)		

Figure 7 Parallel structure–agent dilemmas
Source: Derived from the matrix developed in Hollis and Smith, 1991: 5.

theory with a major problem. If structures and agents are mutually constitutive of one another, where do basic changes come from? For basic changes to take place one or both of two conditions must obtain; the social system must be open to external influences which are powerful enough to disrupt the endless cycle of mutual constitution of structures and agents; or the cycle of mutual constitution of structures and agents must be an imperfect process, with the inconsistencies or shortcomings sufficient to disrupt the self-sustaining process.

Intellectually, the admission of external influences or 'objective' constraints on (and/or internal dysfunctions within) the structure-agent cycle allows analysis to move from the subjective approach to social analysis and to incorporate 'objective' forms of analysis. Forces that impact on the structure agent cycle from outside are clearly external to human consciousness and therefore amenable, in principle, to analysis not conducted primarily in terms of human subjectivities. The analysis of dysfunctions within the structure agent cycle (as in the case of unintended consequences in human affairs and of inconsistencies in beliefs, policies or institutions) also allows analysis to encompass the subjectivity of the involved actors, but to go on to entertain a more 'objective' approach.

Such issues of structure and agent are central to the range of contending approaches to IPE, for they focus on the sources of conduct, and the causes and limits of change. The degree to which such issues have been acknowledged explicitly within the various schools of IPE, however, varies considerably. Marxism revealed a clear practical concern with such issues from the earliest debates within the First International about the form and timing of revolutionary political action. When such Marxists anguished over the suitability of 'objective' conditions for revolution, or the possibility that determined action might accelerate revolutionary processes, they may not have employed the language of structure and agent explicitly, but that was what was being pondered in practice.

Contemporary dependency theorists, and their distant relations in the Structuralist School, reflect the dilemmas of structure-agent more explicitly in their writings and prescriptions. The relationship between external constraints and the action of determined actors being, once again, at the heart of the policy dilemma.

The evolution of realism into neo-realism under the influence of Kenneth Waltz took IR theory in an intentionally structuralist, and 'objectivist', direction. Indeed, it was Waltz's declared intention to develop an IR theory that would permit the deduction of the behaviour of given types of states from the overall structure of the state system and the position within it of that type of state. Expanded to embrace economic factors, STRUCTURAL REALISM brings the neo-realist approach firmly within the broad realm of IPE.

Within political economy, both domestic and international, structural features are clearly emphasized within institutionalist/evolutionary approaches to specific political economies. Structure is also the primary focus of most world-systems and long-cycles analyses. However, the institutionalist/evolutionary approach shades towards a 'subjectivist' approach, while world-systems and long-cycles studies exhibit an 'objectivist' bias.

Analytically, liberal political economy deploys an 'objectivist' ontology. Individuals are inherently rational. Rational dispositions guide individual behaviour that constructs the collective economic context within which all actors then operate. The collective economic context is then the environment within which all individuals have to operate and which influences both outcomes and the subsequent calculations that each individual will make.

Normatively, liberal political economy also enshrines a core concern with the conditions for an unfettered market economy and a free democratic political system. Individual conviction of the liberal gospel and effective action, particularly in the political sphere, is clearly essential for the promotion and preservation of such conditions. In their absence, individuals

will clearly come under onerous objective constraints.

The 'objectivist'/'subjectivist' issue is also evident within the liberal institutionalist theory of international regimes. The language in which the origins and endurance of regimes are described often assumes an 'objectivist' character in its reference to the rational interests of all actors within a given sphere as the basic building blocks of regimes and the 'objective' character of the constraints then exerted by established regimes. However, there is also extensive reference to the central roles of norms and expectations and, with it, the introduction of a potentially 'subjectivist' element to regime formation and maintenance. Indeed, the subjectivist element becomes more clearly evident in the work of those regime theorists who emphasize the role of epistemic communities – of groupings of experts who may form around a given international issue, develop a common expertise and exert a collective influence for 'desirable' regime formation and policy development.

The division between 'objectivist' and 'subjectivist' approaches thus often creates a dilemma for those wishing to study and analyse substantive issues and areas within contemporary IR and IPE. Exclusive adherence to one approach or the other imposes severe restrictions on the analysis: what can be incorporated and what can be said about the sources and character of behaviour. A mixed approach may thus be more fruitful, and can encompass both the subjective character of the values, ideas and expectations of human actors, while also accommodating the structural characteristics and complications that arise when human beings interact in complex patterns. Such a hybrid approach does, however, encounter serious problems of potential confusion in descriptions of behaviour and outcomes, and the danger of muddle in the kinds of arguments that are deployed. These substantial dangers are not, however, unavoidable if care and caution are exercised.

The universal versus the particular

The structure-agent debate leads into further

questions about the nature of the knowledge that can be acquired from a study of human affairs, in general, and of IPE, in particular, and the purposes to which such knowledge can be put. The first question is whether human affairs exhibit universal characteristics or whether each situation and development is, in a significant sense, unique. The pursuit of universal factors, forces and patterns was common to the approaches to human affairs and dominated their emergence as distinct disciplines and/or political doctrines in the nineteenth and twentieth centuries. Marxism sought the universal laws of human development; liberal political economy sought the continuing principles and consequences of rational human action in economic and political spheres; post-Darwinian evolutionary theory sought the biological bases of the development of all living species and of humanity in particular.

Many historians and philosophers have, however, entertained serious doubts about the existence, or ready identification, of such clear universals within the human condition – beyond those of the relatively trivial (from the intellectual point of view) needs to sustain and reproduce life for any species that is to endure. Historians are often more impressed by the complexity, and apparently unique combinations, of factors that underlie the major departures in human history. Philosophers frequently stress the difficulties of establishing the actual existence of universals in an intellectually satisfactory manner.

Challenges to the possible identification of universals raise the serious question as to whether general knowledge of any truth and utility can actually be gleaned from a study of IPE, or of any other aspect of human affairs. It might be possible to generate a deep understanding of past developments, but that understanding will be of seriously limited applicability to present or future issues and developments, and may well not be applicable at all. The value of acquiring such particularistic knowledge, and communicating it to others, will moreover be of primarily aesthetic value, with little practical utility.

A completely particularistic approach would thus entail that prescriptive purposes for the study of human affairs would also have to be reigned in severely or finally abandoned. The long-held hope of using knowledge gained from the study of human affairs to improve the human condition in one desired direction or another would have been found to be a delusion. However, particularism is clearly compatible with a purely descriptive study of conditions, historical developments and institutions which might sustain a valid and valuable form of study, within its own terms of reference.

A partial resolution of the universal/particularistic divide has, however, become available through the development and deployment of complexity theory (or CHAOS THEORY as it was initially, and most popularly, known). This approach, which was developed from the mathematical modelling of such complex, evolving systems within nature as meteorological and climate systems, provides a framework which blends general principles with near-random influences to produce a picture of a dynamic system with an uncertain, but not entirely random, outcome. Critical to the development of such a complex system are both its starting point and the specific influences which then impacted on it as it evolved. The path – its history, immediate starting point and its subsequent meanderings under the impact of sequential influences – is thus *the* story of change and development within a complex system, whether in the meteorological or the human spheres (or their interaction). Path dependence, in which both ‘regularities’ and particulars play a part, is thus central to a study of human affairs based on the perspectives of complexity theory.

Complexity theory also provides a clear view of a number of other presumptions and issues within the study of human affairs. Few, if any, major developments in human affairs will be purely (or even primarily) linear or curvilinear in path and pattern. Moreover, complexity and path dependence suggest, very strongly, that few (if any) significant developments in human affairs are simply reversible: initial conditions,

even on the rare occasions when they can be recovered, will rarely be achieved by returning directly along the path from those conditions – the path ‘back’ will usually be wholly different and entail quite different costs and benefits. History is thus both central and irreversible. The models of micro-economic behaviour and macro-economic dynamics, favoured in orthodox textbooks of economics, are thus seriously misleading if complexity does provide a more satisfactory perspective on human affairs.

If complexity theory, with its path-dependence view of change and development, is the most fruitful for IPE, then the major contending approaches will have to be evaluated for their compatibility with such an approach. Few would encounter insurmountable difficulties – merely having to purge deterministic presumptions or any simple views of the patterns and processes of change and development. Prescription from universal principles and *a priori* computations would not be possible from the understanding derived from such an approach. Modest predictions and prescriptions would, however, be possible on the basis of a judicious blend of general insights, a detailed appreciation of the immediate context of any specific development, and an enhanced sensitivity to the range of deflecting influences that might be encountered and their likely effects.

Empiricism versus rationalism

The adoption of an approach based on complexity theory and the idea of path-dependent development does not, however, fully resolve the question of the source and status of the general insights that must still be deployed in any analysis that is not to be merely empirical description. Many approaches to IPE throughout the years have claimed to be clearly empiricist in their methodology: that is, they have developed their general ideas and insights solely from observations of the world as it is and as it appears to the observer, in an apparently straightforward manner. Such claims, however, have often not been as robust as their advocates thought and have frequently assumed a rationalistic character.

Methodological RATIONALISM is distinct from a more general idea of rationalism as the use of reason and reasonableness to direct individual conduct or collective decision-making. Rationalism more specifically within the study of human affairs is the deployment of rational analysis to cut through the confusions and ambiguities of observed circumstances to identify the factors and forces that must be directing or working through the surface complexities. The identification of the role of the economic INFRASTRUCTURE and of class conflict within classical Marxism is rationalistic in this sense. So, too, is the invocation of the idea of GENERAL EQUILIBRIUM within what is often known as neo-classical economics. In general IR theory, the realist approach drifts from statements about the actual motives of statesmen into rationalistic propositions about the underlying principles – that is, of the pursuit of power and influence – of all international politics.

The problem with the products of rationalistic analysis, however, is their evaluation or 'testing'. Surface realities remain complex in form and apparently ambiguous in implication. Irrefutable 'tests' of the veracity of any ideas or propositions adduced from rationalistic thought may either be impossible or derived from criteria that are themselves generated by a theory, or approach, that has been built on the basis of the same fundamental ideas. The dangers of self-fulfilling prophecies and self-verifying propositions abound within such an approach.

Unfortunately, pure empiricism also encounters its own difficulties. The world that is available to the observed does not signal its own operating principles. Indeed, it does not always flag its own most prominent features: the outbreak of a small conflict might be highly significant for those directly involved, but might be thought to be a matter of relatively little practical or theoretical significance by those further afield. Analysts thus require criteria for establishing the significance of features of the world that they observe and guidelines to the initial selection and ordering of the wealth of information that might be

available. Both initial features of the analytical enterprise require prior ideas about the world, how it works and what, therefore, is most significant. Such ideas constitute theories, however implicit and ill-formed. Such ideas, moreover, when they are not merely acquired pre-formed from others, will be formed by a mixture of naive observation and reflection. Such complexities of information-acquisition and idea-formation afflict all studies of human affairs, must be acknowledged in all approaches to IPE, and caution modesty in claims for the knowledge and understanding generated.

The problem of meta-theory

Many of the problems considered in this discussion are conflated as the issue of the status and role of meta-theories. Many of the more general ideas that analysts bring to bear on the objects of their study can be described as meta-theories (Castles, 1971). They are sets of broad ideas – general insights, criteria of significance and initial paths of entry into the empirical realm – which furnish the starting point for the analysis of inherently complex aspects of reality. The core ideas of meta-theories do not, however, constitute strictly testable propositions in that it is difficult, or even impossible, to construct criteria for their unambiguous falsification and, hence, satisfy the criterion that is often deemed to be critical to a 'scientific' approach.

The inherent unfalsifiability of meta-theories thus excludes them from acceptability by those who are wedded to the hypothetico-deductive approach to research within the social sciences. Such an exclusion, however, imposes severe restrictions on the questions that can be asked about the human condition, the 'answers' that can be accepted and the insights that can be accommodated. It is precisely such restraints on what can be studied, and how, that persuades many students of contemporary IPE to entertain meta-theories, knowingly or unknowingly, as valuable tools for making some sense of a complex and ambiguous world,

international political economy (IPE)

whatever the intrinsic shortcomings of such general perspectives.

International political economy: Purposes and perspectives

IPE is thus a diverse, complex and demanding enterprise. Its intellectual centrality reflects the importance of its subject matter. Current changes in world affairs turn on the complex, intimate and powerful interaction between political and economic developments.

The range of contending approaches to IPE reflects widely differing views about the forces that shape the contemporary human condition and, to an extent that is often overlooked, also reflect divergent hopes for the world and its future. Differing presumptions and purposes interact with a range of difficult philosophical and methodological questions to further complicate the discipline. Recent years have seen the emergence of a wide range of critical perspectives, including post-modernist and post-rationalist IPEs (see POST-MODERNISM; POST-RATIONALIST INTERNATIONAL POLITICAL ECONOMY). What can be known with confidence about the dynamic and ever-changing contemporary international or global political economy remains far less clear than may be wished. An enhanced understanding of contemporary conditions is thus likely to rest on an eclectic and critical approach to the diverse approaches that have emerged during recent development of international and global political economy.

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R.J. BARRY JONES

international relations (IR)

A branch of political science concerned with the behaviour and interactions of state and non-state actors in the global system. Although international relations (IR) is a very old subject of study, it was 'institutionalized' as a discipline rather late, establishing itself mainly after World War I with interest in it peaking during

the COLD WAR. Thucydides, Machiavelli, GROTIUS and KANT were some of the first theorists of international relations.

The study of IR is a rather multidisciplinary project, applying concepts taken not only from political science, but also from history, economics, sociology, GAME THEORY, political theory, (international) law and even psychology. Since it is also a highly policy-orientated field, some of the most important contributions to the literature have been made by experienced columnists and statesmen. However, this 'openness' leads to an oversupply of contributions by journalists, politicians and social scientists, who often substantially distort the very core of IR theory in their attempt to promote their personal, political or ideological agenda.

Today, IR theory deals mainly with the behaviour and relations of sovereign NATION-STATES ('state-centrism') in a world system of semi-anarchy – that is, in a system where, despite the plethora of international institutions, organizations and a body of international law unprecedented in history, the power of the mighty is almost always decisive (despite the opposite rhetoric after 1989 of a new and more cosmopolitan world order). Another field of study for IR is the behaviour and functioning of international organizations, either political (for example, the UN), military (for example, NATO) or economic (for example, OPEC), and of non-governmental organizations (for example, MULTINATIONAL CORPORATIONS (MNCs), revolutionary or secessionist movements, human rights and ecological advocate groups, and so on).

Although economic, political, cultural and military relations between states are the object of IR's study, the emphasis always lies on the problem of warfare. The preparation for war (for example, the arms race), the avoidance of war and the consequences of war, as well as the strategic behaviour of states before, during or after a war (for example, deterrence theory), are some of the most popular subjects in the theory of international relations since Thucydides.

Various theories have been developed for analysing the foreign policies of nation-states

that wish to avoid war without undermining their vital interests (peace, security, economic growth, national independence and identity). Realist theory is the classical theory of IR, first presented by Thucydides and later developed by HOBBS, Machiavelli and many others. For the realists, the absence of a global legal order which could ensure the protection of a nation's interests leads to both defensive and offensive strategies. The state has to protect itself from enemies and pursue its interests without sentimentalism, moralism or wishful thinking (*Realpolitik*), if for no other reason than because its enemies or rivals will do the same. It should thus strive to maintain the current balance of power (status quo) if this serves its interests, or follow a revisionist policy when it feels powerful enough to overthrow the status quo for its benefit. The means for such a realistic policy are military power and international prestige.

NEO-REALISM and STRUCTURAL REALISM are developments and refinements of traditional realist theory into a structural (systemic) theory of the behaviour of international actors that uses the PARADIGM of PERFECT COMPETITION, with its stabilizing equilibrium forces, to study the dynamics leading to the balance of power equilibria in IR. By introducing game-theory concepts, neo-realism studies PRISONERS' DILEMMA situations in which a rational policy-making leads to undesirable results.

Neo-liberal (or liberal institutionalist) theory follows the lead of neo-realism by incorporating more economic (rational-choice) and game-theory concepts in its analysis, by dropping the idealism of old Wilsonian liberalism, but also by rejecting some of the essential elements of traditional realism (see INSTITUTIONALISM, LIBERAL; NEO-LIBERALISM). International actors are utility (interest) maximizers acting in a system of semi-anarchy, where they are nonetheless not independent since they are components of a complex system of interactions and (economic) INTERDEPENDENCE. Consequently, despite the conflicting interests, cooperation between states is almost always the winning strategy, since complementary interests may be (or become) more decisive. These

interests can be advanced through the creation and maintenance of international organizations.

Despite the development of many theories contesting traditional realism, its mainstream status remains intact. Not only because it is difficult to construct an IR theory without a theory of (national) interest as its nucleus, but also because most decision-makers remain hard-core realists.

See also:

diplomacy; law, international; new world order; North Atlantic Treaty Organization (NATO); Organization of Petroleum Exporting Countries (OPEC); United Nations (UN)

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ARISTIDES N. HATZIS

International Sea-Bed Authority

The International Sea-Bed Authority is a body that was established by the Third United

Nations Conference on the Law of the Sea (UNCLOS III) to regulate commercial exploitation of mineral deposits on the beds of the high seas which were declared 'the common heritage of all mankind'. This UNCLOS III Treaty component generated much controversy between developed and developing nations over twelve years (1982–94), with many of the former refusing to ratify what had been originally agreed. The controversy focused on the authority's exclusive role in sanctioning exploitation of those resources and in distributing the returns from any commercial mining equitably among all countries: disputes were to be adjudicated by a Sea-Bed Disputes Chamber of the International Tribunal for the Law of the Sea at the Hague.

The authority was eventually established in 1994 (based in Jamaica) after complex negotiations over its council's membership and voting system, which illustrate the problems of creating international regulatory bodies through consensus. Members are elected in five categories:

- 1 four seats reserved for countries which consume more than 2 per cent of any commodities produced from minerals that are mined from the sea-bed;
- 2 another four elected from the eight states which are spending most on commercial exploitation;
- 3 four states which are net exporters of the exploited minerals;
- 4 six developing states with special interests (such as those which are 'land-locked or geographically disadvantaged'); and
- 5 eighteen states 'elected according to the principle of ensuring an equitable geographical distribution of seats in the Council as a whole'.

The United States and the Russian Federation were both elected for two-year terms in Category 1 in 1996, with the understanding that both could be elected for further four-year terms if they wished, and Germany and India were elected on the same terms in Category 2. Decisions on most issues require either a two-

International Securities Markets Association (ISMA)

thirds or a three-quarters majority of those present and voting.

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RON JOHNSTON

International Securities Markets Association (ISMA)

The International Securities Markets Association (ISMA), formerly the Association of International Bond Dealers (founded 1968), has played an important role in codifying industry practice in the Eurobond market. In 1986, the United Kingdom gave it authority to regulate the London-based Eurobond market and it presently operates as a recognized exchange.

TONY PORTER

international security

The need for *international* security, as opposed to merely security, derives from the nature of the international system. Security – the perception of physical safety and freedom from fear – cannot be guaranteed because the international system is anarchic. The world is a self-help system in which each state must do all it can to protect its vital interests and ensure that those interests are protected in the future.

Broadly, there are two means by which states can ensure their security and that of the state system: balance of power and the liberal peace.

According to the realist school of international relations (IR) theory (see **REALISM**), states should seek a balance of power, whereby they join forces to balance the power of another state or group of states. This deters potential aggressors by making any attack by them costly and uncertain. Liberal theorists, however, suggest that states can protect their security by following international laws, negotiating to resolve their security concerns, creating and joining international organizations (IOS), promoting the spread of democracy and economic interdependence, and agreeing to reduce armaments.

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PAUL G. HARRIS

international standards

One of the most important impediments to free trade is differences in technical standards for products. The adoption of a different set of standards for a particular product by a country may effectively deny market-access to producers in other countries where these standards differ. For example, if one country uses a different width of railway track to that of other countries, the effect may be to give a monopoly to domestic producers of rolling stock. The issue of technical standards has been an important one in the consumer-electronics industry. At the present time, different producers of high-definition TV (HDTV) have invested heavily in different formats, United States and European producers in a digital standard and the Japanese in an analogue system. Unless Japan reverses its previous policy, it is likely to face exclusion from major parts of the future world-market. Members of the **WORLD TRADE ORGANIZATION (WTO)**,

however, are required to adhere to a code governing technical standards, which seeks to prevent countries using different standards as a protectionist device.

See also:

non-tariff barriers

NIGEL GRIMWADE

International Telecommunication Union (ITU)

A specialized agency of the UNITED NATIONS (UN), this intergovernmental organization (headquartered in Geneva) is a direct descendant of the old INTERNATIONAL TELEGRAPH UNION (ITU). It functions to provide an international organizational framework for the development of telecommunications regimes. The ITU's standards facilitate the interconnection of telegraph and telephone services. It also regulates the use of the radio part of the electromagnetic spectrum: allocating frequency bands to particular services on a regional and global basis (for example, to broadcasting, air traffic control, mobile telephony and so on) and, working through national administrations, assigning and registering specific frequencies to particular users. A significant extension of its work has been in the global allocation and registration of frequencies and orbital slots for all types of satellite communication. Thus the ITU performs a very significant task in the management of extensive electronic INTERDEPENDENCE. Always affected by rapid technological change, the ITU has had to respond to the demands of less-developed countries for equity in world communications; to the increasing convergence of communications technologies, and to the emergence of highly competitive global markets in what used to be the sole preserve of monopolistic national post and telecommunications authorities. Its governing Plenipotentiary Conference responded in 1992 with a decision to restructure

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JOHN VOGLER

International Telegraph Union (ITU)

The first of the public international unions of the nineteenth century, it was created in 1865 to administer the new International Telegraph Convention. Representing (alongside the UNIVERSAL POSTAL UNION (UPU) of 1874) a new trend in functional integration cooperation, it enabled the electric telegraph to become a usable international communications system, connecting twenty European countries. by developing a common set of interconnection standards and operating and tariff rules. Arguably, it was the first modern international organization The

International Telephone and Telegraphy Company (ITT)

modern INTERNATIONAL TELECOMMUNICATION UNION (ITU) was created in 1932 from the merger of the existing International Telegraph and Radiotelegraphy Unions.

JOHN VOGLER

International Telephone and Telegraphy Company (ITT)

Founded in 1920 as a telephone company by Sosthenes Behn, by the late 1960s and early 1970s ITT had become the eighth largest MULTINATIONAL CORPORATION (MNC) in the United States and the largest US multinational in Europe. ITT was one of the first major diversified conglomerates, controlling at its apex 331 subsidiaries with operations in over seventy countries. Although founded on the telephone and telegraphy industry, ITT diversified into hotels (Sheraton), car rental (Avis) and many other sectors. Its growth in the 1960s in particular attracted the attention of the US government's anti-trust authorities, who attempted to force the company to divest many of its holdings.

However, ITT's notoriety stems from one of the most nefarious examples of intervention by a multinational corporation in the politics of a host state. In the early 1970s in Chile, ITT tried to protect its interests in the profitable CHIT-ELCO telephone company by seeking to prevent the election of Marxist-oriented Salvador Allende as president. ITT's efforts to undermine Allende included giving monetary support to his political opponents and pressuring the US government to disrupt the Chilean economy. Secret documents have subsequently revealed that ITT had been in direct contact with the Central Intelligence Agency regarding covert operations.

Throughout the 1980s and 1990s, ITT foundered with the company divesting itself of many of its subsidiaries. In 1986, the French Compagnie Generale d'Electricité (CGE) merged with ITT's telecommunications opera-

tions, creating Alcatel. Then, in June 1995, ITT announced a demerger that split the conglomerate into three separate business groupings: insurance, industrials and leisure. Finally, two years later, the leisure group announced a further demerger, dividing into three additional groupings (hotels and casinos, telephone directories and educational services), with only the hotel grouping keeping the ITT title.

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JASON P. ABBOTT

international trade

By definition, a market exists whenever a buyer and a seller enter into an agreement to exchange goods or services. These days, the markets for many goods and services are international because modern methods of communication make it possible for a buyer and a seller living on opposite sides of the world to enter into such an agreement. The market for many goods and services is therefore worldwide. However, the market for a wide range of services often remains localized. This is because certain kinds of services (particularly personal services such as hairdressing, dry cleaning, shoe repairs, car servicing and so on) require the buyer and seller to be in actual physical contact, and it is generally not worth the service buyer going a long distance to purchase the service required. Increasingly, however, many services can be performed even where the buyer and seller are long distances apart. For example, financial services can be bought and sold over the telephone or even on the internet.

Major technological advances in methods of

transport have helped to expand the market for most goods. However, in the case of some goods, the costs of transportation may be so high relative to the value of the final product that the good can only be profitably sold within a limited geographical area. Bulky products such as glass bottles, coal or bricks must of necessity be sold within a reasonably close distance of where they are produced. The same may be true of certain perishable products (for example, milk), although modern methods of refrigeration can preserve the product for relatively long periods of time.

In other cases, the geographical limits of the market are set by differences in consumer tastes. Where consumers in different countries have highly specific tastes for particular products or types of products (for example, within the food and drinks industry), the market for a good will be confined to a particular country or region. Finally, trade barriers put up by governments fragment the market for most goods. However, the progressive lowering of **TARIFFS** and **NON-TARIFF BARRIERS (NTBs)** for most industrial products over the past half century has contributed towards a marked expansion in the size of the market and caused the markets for many goods to become increasingly international.

See also:

globalization; transport costs

NIGEL GRIMWADE

international trade cycles

It would be expected that – as the total population of the world increases, together with total levels of **INVESTMENT** and the ability of more and more people to buy goods and services – the total amount of **INTERNATIONAL TRADE** would also increase. However, this is not always the case, since total levels of trade – as well as levels of trade in particular industries and in particular geographic locations – vary according to cyclical patterns. The extent and

the duration of the cyclical effects vary wildly and no theoretical position is able satisfactorily to explain or predict future events on a global scale.

It is the complexity and multifarious nature of international trade that makes it so difficult to understand and predict cyclical effects. For example, there is reason to believe that climatic change operates cyclically and this has a direct impact on the productivity and profitability of agricultural industries – but **GLOBAL WARMING** and environmental degradation make its effects less and less feasible to predict accurately. **TECHNOLOGY** also has an impact: the innovations that lead to the majority of new technologies generally come from the industrialized countries, particularly Japan and the United States. New technology increases the trade of the innovating country, but then diffuses to other countries, as understanding of the new processes and products becomes more widely disseminated – the effect on the originating country therefore dissipates, while there are increases in the trade of those countries who are able to produce and distribute goods using the technology most cheaply. Finally, the technology becomes so widely dispersed that its effects on international trade become minimal.

International trade may be encouraged or discouraged by various government policies and, in the past, the misguided application of some policies has led to economic **DEPRESSIONS** and slumps. These days, the increased importance and value of international capital movements means that these movements are far more likely to influence cycles of global economic activity than is government policy.

JOHN WALSH

INTERNATIONAL TRADE ORGANIZATION (ITO) *see* General Agreement on Tariffs and Trade (GATT); World Trade Organization (WTO)

international trade unionism

International trade unionism refers to the establishment of links between unions in different states and the establishment of trade union organizations specifically designed to transcend national boundaries. Trade unions have always, at least in principle, been in favour of international links, partly due to the recognition that **CLASS STRUGGLE** is not contained within national boundaries and partly to counteract the power of capital to bypass those boundaries. Activities include campaigning for union rights and codes of conduct for transnational corporations (see **MULTINATIONAL CORPORATIONS (MNCs)**); acting as information and communication centres on trade union issues; providing political, financial and educational support for unions around the world, and, in some instances, supporting striking unions in one country through boycotts and simultaneous strikes in others.

International links have been forged through bilateral union contacts and the creation of international trade union organizations. However, differences in political outlook and allegiance, and in wages and working conditions, generate tensions within the movement. These factors, along with the increasing mobility of capital (see **CAPITAL MOBILITY**) which leads to competition between labour in different countries to attract investment, mean that the objective of international **LABOUR SOLIDARITY** has never fully been realized. Labour movements are still, on the whole, tied to the nation state and this tension is reflected within the international trade union movement.

Historically, there are two main forms of international trade union organization, both of which emerged around the turn of the twentieth century. First, there are the International Trade Secretariats (ITSs). These are transnational associations of unions in a given industry, which tend to focus their activities in areas directly related to their industrial sector. One of the most powerful ITSs has been the International Transport Workers' Federation (ITF), which was established in

1896. Activities include a campaign, started in 1948, to eradicate the **FLAGS OF CONVENIENCE (FOCs)** system for shipping or at least to establish minimum international standards for such vessels. The campaign has included lobbying of governments and ship-owners to adopt ITF minimum standards. This has only been possible because the affiliation of various seafarers' and dockers' unions to the ITF means that it can produce a coordinated, international campaign.

The second type of international trade union organization consists of federations of the national trade union centres of various countries, such as the Trades Union Congress (TUC) in the United Kingdom and the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) in the United States. While the ITSs have tended to focus their activities on industry-specific questions, the federations have had a more active political role. This is largely because the federations of national congresses have tended to parallel the division of the labour movement into communist and non-communist camps. Before World War II, the two main federations were the International Federation of Trade Unions (IFTU) – a non-communist federation consisting of some European centres and the American Federation of Labour (AFL) – and the Profintern, also known as the Red International of Labour Unions (RILU). This latter organization was in direct competition with the IFTU and, as the RILU affiliates were charged with the task of infiltrating and taking over their national trade union centres, great hostility existed between the two.

This situation changed in 1945 when an increased desire for, and optimism about, international solidarity led to the formation of the World Federation of Trade Unions (WFTU), which included communist and non-communist unions. This international union became one of the first sites of Cold War tension, with the non-communist unions splitting in 1948 and establishing their own organization in 1949: the International Confederation of Free Trade Unions (ICFTU). The ICFTU and the WFTU battled it out for

influence until the end of the Cold War, which led to the collapse of the WFTU. ICFTU members now include, for example, the National Free Trade Union Confederation of Romania. The ICFTU in 1997 had 195 affiliated national centres from 137 countries, covering a membership of 124 million workers. The ICFTU also has strong links with the INTERNATIONAL LABOUR ORGANIZATION (ILO) and with the International Trade Secretariats. While there has also been a tradition of Christian internationalism, which has attempted to maintain a distinct identity, this has not been so significant.

There are also regional links between unions. One regional development has been as a response to organizations such as the European Union. The European Trade Union Confederation (ETUC), founded in 1973, is recognized as a social partner by the European Commission and works to represent trade unions and workers generally as Europe moves towards economic integration. Bodies such as the ICFTU also have regional organizations, including the Asian and Pacific Regional Organization (APRO).

International trade unionism has three sources of significance. First, membership of international organizations can provide access to resources. Since the ICFTU only supports 'free and bona-fide unions', which did not include communist unions, this would strengthen non-communist national trade union centres. For instance, finance from the AFL and involvement in the ICFTU led to the strengthening of Force Ouvrière in France in the immediate post-war period. The ICFTU, along with individual trade union centres, has also been active in the DECOLONIZATION process and in the developing world, bolstering 'responsible' (namely, non-communist) trade unions and attacking communist-influenced ones, for example, in Latin America.

Second, because of this influence over the development of national trade union movements, international trade unionism has been an important instrument of national foreign policy, both for the East (where union movements were controlled by the state) and for the

West. Strong links developed between union leaders and government organizations in the United States and in Britain during World War II, links which deepened during the years of the Cold War with the international trade union movement being one of the major loci of Cold War politics. One issue of controversy in the West has been over the relationship of trade union movements with the United States' Central Intelligence Agency (CIA).

Third, international trade unionism has had some importance as an actor in the world economy, fighting for trade union rights and minimum standards. Current activities of the ICFTU include campaigning for trade union rights in EXPORT-PROCESSING ZONES (EPZs) and for the abolition of child labour. Aspects of GLOBALIZATION, such as the relocation of industry, are seen as a threat to Western unions, leading to the destruction of traditional areas of industrial production. The rise of the NEWLY INDUSTRIALIZED COUNTRIES (NICs) has led to tension between the goal of the ICFTU to represent a united international trade unionism in forums such as the ILO and the divergent views of national organizations. Negotiations over the URUGUAY ROUND of the GATT and the creation of the WORLD TRADE ORGANIZATION (WTO) revealed tensions between constituent members in Asia, the United States and Europe over the issue of minimum wages.

In recent years, there has been a decline in the power of the international trade union movement. In part this reflects the decline in the Western world of trade unions in general, with falling membership, and a shift away from CORPORATISM and Keynesian demand-management (see KEYNESIAN ECONOMICS) towards DEREGULATION and the tightening of trade union law. It also reflects the relative economic decline of countries with historically strong labour movements and the increasing ability of capital to shift to areas where labour costs are low. Furthermore, the end of the Cold War has led to a decrease in the political role of international trade unionism, as areas of conflict shift and change. While improvements in information technology make it easier to

internationalization

maintain international contacts, it also means it is easier for unions and workers' groups to establish their own links with overseas counterparts bypassing their national centres. It is likely that in the future there will be more informal links between transnational workers' groups, rather than the traditional structured form of international trade unionism.

International trade unionism is a subject which has not been explored to any great extent by the literature on international political economy (IPE). Realists have touched upon it as an arm of state power during the Cold War (see REALISM). For pluralists, it is one of many competing interest group networks in the international arena. Marxists and neo-Gramscians (see MARXIAN ECONOMICS; NEO-GRAMSCIANISM) tend to place more stress on the importance of labour and so, for instance, note the role of international trade union links in the development of Fordism. However, there does not tend to be a systematic attempt to theorize the role and impact of international trade unionism on IPE.

See also:

Fordism, crisis of; Fordism, developmental model of; Fordism: mode of regulation; Fordism: regime of accumulation; General Agreement on Tariffs and Trade (GATT); labour, international; labour solidarity; trade unions; unionization

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RHIANNON VICKERS

internationalization

Internationalization is the process whereby the actors (people, organizations and societies) within one state become influenced by and have influence on the actors of another state. It is this more general process to which people often refer when they speak of GLOBALIZATION – which means the practice of choosing locations for stages of production of some parts of goods and services on the basis purely of cost-effectiveness and ignoring geography altogether.

It is useful to distinguish between three levels of internationalization: the personal, the organizational and the societal. Of these three, the most important in terms of international political economy (IPE) is the organizational level, to which most attention will be paid in the following article.

Internationalization at the individual level

At the individual level, people become subject to internationalization through moving to other countries and experiencing different cultures and influences – both as tourists and more permanently as migrants or migrant workers – and through being subject to transborder media such as television, radio and advertising. Clearly, this kind of internationalization is highly dependent on geography and can be one-way in its effect. For example, the people of

Laos are subject primarily to the internationalizing influences of neighbouring and more powerful Thailand, and to a lesser extent to more politically congruent Vietnam and China. At the same time, Thailand is subject to the influences of American cultural media and icons – while people in America remain unaffected by events in Thailand and, indeed, most other places. This type of influence is not always welcomed by state rulers, especially when values and beliefs are being inculcated which are inimical to state-sponsored values and beliefs. In Turkey, for example, certain clothing styles are unwelcome as they may reflect a more fundamentalist form of Islam than the secular state authorities wish to permit; by contrast, the Ayatollah Khomeini referred to the growing influence of Western moral values and the commercialization of private life as (in translation) ‘Westoxification’.

It is clear that internationalization in this sense is not a new phenomenon, although it may be argued that the pace and scope of change has increased and is likely to increase further, together with higher penetration of telecommunications and information technology around the world. It is also clear that the spread of international influences will frequently occur within regions rather than being disseminated on a global basis. For example, Japanese and Chinese pop music is very popular throughout much of East Asia but has little impact on the rest of the world; similarly, developments and debate in many schools of thought and philosophy that are important within the Islamic world are largely unknown in the rest of the world.

Internationalization at the societal level

Internationalization at a societal level is perhaps best seen in the integration of countries into the international system of capitalism, which is a process that has intensified as more countries embrace market-friendly principles and as multilateral organizations such as the WORLD TRADE ORGANIZATION (WTO) are able more effectively to regulate international economic activities. This form of internationalization

sees states adopting, to a greater or lesser extent, the set of policies that are considered to best provide macro-economic stability: these policies include privatization of state-owned assets, liberalization of domestic markets for overseas competition, reduced government intervention in economic affairs and promotion of free trade in importing goods and services. Noam Chomsky describes this policy-mix as the ‘WASHINGTON CONSENSUS’ (1999: 19) and evaluates the power that it provides for multinational enterprises.

Although there are some states for which this proscription has been successful, the example of Russia and various former Soviet satellite states has demonstrated that without a strong state capable of creating and maintaining the institutions necessary to support a market-based system, economic chaos and gangsterism can become rampant.

Internationalization at the organizational level

It is this form of internationalization that is most commonly discussed in IPE. Discussion centres upon the ways in which organizations spread from a home country to other countries, and their motivations for and success in doing so. Organizations are generally commercial firms and are described as such here, but they could also be NON-GOVERNMENTAL ORGANIZATIONS (NGOs) or social organizations. Discussion also concerns the degree to which large, internationalized organizations are able to wield power separate from that wielded by the states in which they operate and the implications of this.

A basic theory of internationalization from a business perspective is that firms, with a view to increasing profits, will look to undertake business activities in other countries. First, they will commit low levels of resources to another market (perhaps through exporting). As knowledge about the overseas market increases, so too does confidence within the firm and higher levels of resources are committed (perhaps opening a branch office or even a manufacturing facility overseas) and

new markets are approached. Markets will tend to be selected on the basis of how much information is available about them, which lowers the risk. Scandinavian firms look first to their Scandinavian neighbours, then other states in northern Europe, the United States and Canada, and then perhaps Mediterranean states. British firms, meanwhile, would have more knowledge of Commonwealth states and so internationalization to countries such as Australia and India would occur at an earlier stage than for French firms, for example, who would more readily turn to north Africa or mainland south-east Asia. In any case, the model suggests a succession of steps in internationalization of increasing levels of commitment, which are driven by the need to increase profits and are determined by the level of specific market-knowledge.

To this basic model may be added many refinements resulting from the complexity of international business in the real world. Additional phenomena to be accounted for include the possibility of global start-ups, the greater importance attached to and prevalence of cooperative agreements between firms, and the possibilities for the globalization of production. One influential model for understanding the internationalization process is John Dunning's eclectic paradigm. According to this, firms will undertake activities in overseas countries either for market-seeking reasons (that is, to sell more products) or for resource-seeking reasons (that is, to gain access to some necessary facet of production). Firms can seek to perform these activities either by market-based transactions (for example, exporting or buying resources and importing them) or else can establish a presence in the particular country concerned. They will choose to do the latter when they have an advantage over domestic firms in that country which allows them to undertake activities more efficiently and profitably than domestic firms. Such advantages may be of three types: ownership, location or internalization. Ownership advantages result from possession of proprietary information, intellectual property or perhaps a famous brand name to which other

firms do not have access; locational advantages include access to resources which are unevenly distributed (for example, US firms have greater access to venture capital while Australian firms have greater access to mining technology than most competitors); informational advantages represent the greater efficiency that particular firms have in organizing the assets under their control (for example, supermarket chains can import and distribute goods to many locations at lower cost than small individual shops).

This model of internationalization provides a good understanding of why firms would wish to move activities overseas but is inadequate when trying to describe how they do so. This shortcoming is remedied to some extent by works such as that by Peter Buckley and Marc Casson (1998).

Firms that have become large and operate in many different markets around the world can certainly wield considerable power and, in some cases, more power than the governments of the states hosting their activities. This has led to concern in many quarters that this power will be abused, for example, by firms exploiting workers in one country to provide profits which are moved overseas, or by ignoring environmental good practice. While cases of such abuse continue to be chronicled, most (if not all) governments now welcome inward investment by internationalizing firms because this can lead not only to greater employment and tax revenue but also to the upgrading of skills within the labour market and the stimulation of domestic firms in support industries, not to mention the fact that competition tends to improve the quality of domestic firms rivalling the overseas firms.

See also:

boundaries; trade, inter-firm and intra-firm; transnationally integrated production

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JOHN WALSH

interstate system

The interstate system is an ungoverned system of NATION-STATES whose state-makers not only establish authority within their territory but also enter into relations with each other. In this system, no state formally dominates the others, but their ultimate goal is to conserve the status quo. The interstate system can be understood as an area of continuous conflict and cooperation between nation-states.

The nation-state is a relatively new form of organization for human affairs. Its roots lie in the Peace of Westphalia of 1648 that formed the basis for the modern nation-state system and the mutual acceptance of the SOVEREIGNTY of states. At that time, the world consisted of various systems that had their centre and a zone of diminishing control, as did (for example) the Ottoman Turk and Safavid Persian empires in West Asia, the Mogul empire in India, Ming China, the German and Russian empires in Europe, the Incas and Aztecs in Latin America, as well as empires in west and east Africa.

New means of transportation and communication, and the breaking up of Continental European empires were important factors that made possible the expansion of the interstate system all over the globe. Since its emergence in the seventeenth century, there has been a

constant power shift in the system. As the first industrialized country, Britain became the most powerful state in the nineteenth century. This role was taken over by the United States at the beginning of the twentieth century. The implementation of the liberal principles of world economy and the centralization of international financial activities in Britain at the end of the nineteenth century helped the interstate system to play an underpinning role to the global expansion of CAPITALISM.

In the twentieth century, national sovereignty persists but has become more compromised by the globalization of the global political economy. Further, issues such as ecology, nuclear weaponry and human rights are not only dealt with by each country individually, but have also become the subject of international concern. That concern is expressed mainly through international institutions such as the UNITED NATIONS (UN), INTERNATIONAL MONETARY FUND (IMF), WORLD BANK, the WORLD TRADE ORGANIZATION (WTO) and WORLD HEALTH ORGANIZATION (WHO), and the INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs) such as Greenpeace and Amnesty International.

In the second half of the twentieth century, especially since the 1970s, the role of transnational corporations (TNCs) has become increasingly important in the global political economy. TNCs have developed into the key agents managing investment, production and labour on a global level, crossing national boundaries for the spatial optimization of production and profit opportunities.

More recent developments also include the expansion of regional economic organizations such as the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), MERCOSUR or the ASEAN FREE TRADE AREA (AFTA). The most advanced among them is the European Union.

These developments have led to a rethinking of the theoretical approaches within international relations (IR) and international political economy (IPE). Since the 1970s, the realist view that considers the state as the primary analytical unit in IR and IPE has been

intra-industry trade

challenged by theorists who argue that the world is not a construction of independent nation-states but one global political system. According to liberals, Marxists and constructivists, not only nation-states but also different political actors with an interstate, transgovernmental or transnational character have to be taken into account on the international political scene. For example, **WORLD-SYSTEMS THEORY** (which derives from **DEPENDENCY THEORY**) considers the world to consist of only one capitalist system. Nation-states are subordinate to world economic exchange relations, but are a necessary precondition for the existence and structure of this system.

See also:

interdependence, complex; nation-state; nationalism; neo-Gramscianism

MEHDI PARVIZI AMINEH

intra-industry trade

Intra-industry trade is defined as the simultaneous export and import of products belonging to the *same* industry. By way of contrast, inter-industry trade is the exchange of products belonging to *different* industries. Thus, if Britain exports cloth to the United States and the United States exports wheat to Britain, the result is inter-industry trade. Inter-industry trade tends to occur between countries which possess *different* **FACTOR ENDOWMENTS** (land, labour and capital). If the US is well endowed with land suitable for wheat farming, the costs of producing wheat will be relatively low and the US will enjoy a **COMPARATIVE ADVANTAGE** in wheat production. By way of contrast, if Britain is well endowed with labour and cloth production is a labour-intensive industry, Britain will enjoy a comparative advantage in cloth. If the two countries engage in trade, then – all other things being equal – inter-industry trade will result.

However, where countries possess *similar* factor endowments, there is little scope for

inter-industry trade and intra-industry trade is more likely to result. For example, Britain and Germany possess broadly similar factor endowments. Yet Britain exports Rovers to Germany and Germany exports BMWs to Britain. The costs of producing cars may have been much the same in the two countries. However, consumers want variety: some British consumers prefer BMWs to Rovers, while some German consumers prefer Rovers to BMWs. Intra-industry trade results, therefore, from the existence of differences in consumer preferences for different varieties of the same product. In the case of manufactured goods, the degree of product differentiation is quite high and hence a relatively high proportion of trade is of the intra-industry type. By way of contrast, primary products tend to be more homogeneous, such that levels of intra-industry trade are much lower.

Although the existence of product differentiation is one of the factors which may explain why countries exchange products belonging to the same industry, it does not tell the whole story as to why this happens. We still need to account for why producers in different countries choose to *specialize* in the production of particular goods within a given industry, rather than produce the full range of goods which the consumer wants to buy. The explanation lies in the fact that, in differentiated goods industries, production tends to take place under conditions of decreasing average cost (or increasing returns to scale). That is to say, the costs of production per unit fall with the volume of output. This is because the production of differentiated goods necessitates producers incurring heavy fixed costs before production even takes place. If these costs can be spread over a large volume of output, unit costs will be lower. Now, if the local market for a particular variety of a product is greater in one country than another, it follows that producers in that country will enjoy a cost advantage over producers in other countries where local demand is biased more towards other varieties.

The type of economies of scale which are most likely to generate intra-industry trade are those associated with long production runs. In

many industries, considerable cost savings are likely to result from keeping the production line going for as long as possible, because of the costs that will otherwise have to be incurred from closing down production and starting up again. Long production runs can be achieved even in quite small plants if these specialize in just a few products. By way of contrast, even a very large plant may produce at relatively high unit-cost because it is producing too large a number of products. Research-intensive industries are industries in which product specialization is likely to be particularly beneficial (for example, pharmaceuticals). These are industries characterized by relatively high levels of spending on research-and-development (R&D) relative to turnover and where, because of the rapid rate of product innovation, products typically have quite short market lives. In such industries, it is important for producers to recuperate the costs incurred in the development of a product as quickly as possible. To do so, they need to sell a large amount of the product. They also need to sell at a price which recovers these costs as quickly as possible. Intra-industry specialization can provide an escape route. If each producer specializes in a narrow range of products, they can spread R&D costs over a large output. Instead of competing through lowering prices, firms will seek to expand market-share by discovering new products or improving existing ones.

Statistically, the proportion of world trade which constitutes intra- as opposed to inter-industry trade has been rising over the last forty years. One attempt to measure intra-industry trade found that the proportion of trade in manufactured goods of the Western industrialized countries which was intra-industry rose from 54 per cent in 1954 to 57 per cent in 1965 and 60 per cent in 1974. More recent estimates show that the proportion of world trade which has been of the intra-industry type has grown still further, although there may be some evidence to suggest that it has begun to taper off. The highest levels of intra-industry trade occur when the advanced industrialized countries trade with each other. Since these countries possess broadly similar factor en-

dowments and produce relatively large amounts of differentiated consumer goods, this is to be expected. By way of contrast, a much greater proportion of trade between the Western industrialized economies and developing countries is of the inter-industry type.

There is also some evidence to show that levels of intra-industry trade are higher between countries grouped together in a regional trading area. One explanation for this is a tendency for large MULTINATIONAL CORPORATIONS (MNCs) to rationalize their production on a regional basis. Within any given regional trading area, such as the European Union, the different plants located in different countries each specialize. Such specialization may take the form of each plant concentrating on the production of a single good in order to gain the advantages of long production runs (horizontal specialization). For example, one plant may specialize in washing-machines, another in microwave ovens and another in dishwashers. Alternatively, each plant may specialize in the production of a particular component or part (vertical specialization). For example, within the automobile industry, individual plants often specialize in different parts such as carburettors, gear-boxes, engines, radiators and so on. Such specialization may account for the high levels of intra-industry trade which appear to result from the lowering of TARIFF and NON-TARIFF BARRIERS (NTBs) within the same regional trading area, such as has taken place in the EU, particularly following the creation of the Single Market.

To the extent that the growth of intra-industry trade results from increased intra-industry specialization, it has some important consequences for trade policy. Where trade liberalization results in inter-industry specialization, it will bring welfare gains to all countries who participate. However, considerable adjustment problems may arise in the short-run as factors of production (labour and capital) have to move out of declining and into expanding sectors. A consequence may be considerable structural unemployment among workers whose jobs have disappeared due to import expansion. There will also be

distributional effects as the incomes of the country's scarce factor of production (for example, labour) fall relative to the incomes of the country's abundant factor (for example, capital). According to a well-known theorem (the Stolper-Samuelson theorem), the incomes of the scarce factor may even fall in absolute terms. It follows that governments are likely to face strong resistance from the owners of a country's scarce factor in lowering trade barriers, whether unilaterally or through negotiation.

However, intra-industry specialization is likely to give rise to fewer adjustment problems and no distributional effects. By definition, intra-industry specialization requires only that resources shift *within* and not *between* industries. Rather than producing all the varieties consumers need, producers now concentrate on only a range of types. In addition, the factor proportions required to produce goods which belong to the same industry are likely to be similar, so that intra-industry specialization should not affect relative factor prices to the same extent as inter-industry specialization. For both these reasons, trade liberalization which leads to intra-industry specialization is likely to meet with less domestic resistance than trade liberalization which leads to inter-industry specialization. This may explain why the Western industrialized countries have found it easier to lower trade barriers on their trade in industrial goods (which they trade with each other) than on other kinds of trade. For example, much less progress has been made in lowering trade barriers on primary products where inter-industry trade is more important. Also, Western industrialized countries have generally been more protectionist towards developing countries, including the newly industrializing countries, where levels of intra-industry trade are generally lower.

On the other hand, the gains from freer trade are likely to differ under intra-industry from those under inter-industry specialization. The main gain from trade liberalization under inter-industry specialization comes from lower prices. The gain to consumers from lower prices generally exceeds any loss to domestic

producers in the previously protected industries and to governments from lost tariff revenue. In the case of intra-industry specialization, however, prices may fall by less because imports are not perfect substitutes for domestically produced goods. (A BMW made in Germany is not a perfect substitute for a Rover made in Britain in the same way as wheat grown in Canada is a near-perfect substitute for wheat grown in East Anglia.) On the other hand, consumers will benefit from having more varieties of a particular product to choose from. Some consumers will now be able to buy a variety closer to their ideal type than before, while other consumers will gain from being able to buy more different varieties of the same good. It will also be the case that intra-industry specialization will, as we have seen, enable producers to produce at lower unit cost. In this case, either consumers will gain because prices are lower or producers will earn higher profits which can be reinvested in R&D leading to further product improvements or new product discoveries in the future. There are, therefore, no grounds for supposing that the gains from intra-industry specialization will be any less than those resulting from inter-industry specialization, and they may conceivably be greater.

See also:

comparative advantage; economies of scale; product differentiation; regionalism

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NIGEL GRIMWADE

investment

The term 'investment' can be difficult to accurately define, as it has a different emphasis depending on who is discussing it. In everyday terms, investment is basically the purchase of any asset or indeed the undertaking of any financial commitment that involves an initial sacrifice followed by subsequent gains to the investor. For example, buying shares on the STOCK MARKET is an investment, as is the decision to go to university.

In terms of the economic theory of 'income determination', however, investment strictly means expenditure on capital goods. To this end, investment is the amount by which the stock of capital that a firm or an economy has changes, once any allowances have been made for the replacement of capital that has been scrapped. In other words, investment is the purchase by a firm of equipment or materials that will add to that firm's stock of capital. The total of all investment in an economy is known as the 'gross investment' and is particularly important when considering an economy's level of overall development and economic growth. For example, in the years after World War II, many countries found themselves in a position whereby manufacturing equipment, if it existed, needed to be replaced with new and better technology. Through this, the levels of production increased, as did the level of productivity. This increase in gross investment led to

very high levels of growth in the West in the post-war period, financed to a large extent by such devices as the reinvestment of profits and a range of fiscal incentives put forward by governments to encourage investment. Nevertheless, as the need for raw materials to meet domestic demand grew and manufacturers searched for alternative markets, the level of foreign investment increased. Despite the fact that for as long as trade has taken place, there has been an international element in the conduct of its investments, the character and degree of international investment has changed dramatically since World War II, particularly given the prominence of the MULTINATIONAL CORPORATION (MNC). Thus, in the post-World War II period, a large amount of foreign investment was composed of multinational firms with their headquarters in one industrialized nation, basing a portion of their operations in other industrialized nations – for example, a large number of US firms based parts of their operations in European countries. Perhaps more significantly, however, a significant amount of foreign investment constituted the siting in developing countries of the other operations of firms whose headquarters were in industrialized nations, a practice that has promoted a high degree of debate in the literature on international political economy (IPE).

In particular, in the 1950s and 1960s, most developing country governments encouraged a high degree of foreign investment in their countries and thus placed few restrictions on the operation of foreign investors in their states (Latin America was the exception, with its advocacy of the Calvo doctrine). The problem with such action centred around the question of the level of DEPENDENCE on industrialized states that is then created for developing countries, particularly given that such investment tended to control the sectors in a country that were most important to technological development, modern industrial development and exports.

With this in mind, during the 1970s, many Southern governments (see SOUTH, THE) embraced the tenets of the Calvo doctrine and altered their policies of being an open door to foreign investment. Moreover, as nationalist

investment banks

sentiments developed in the industrialized countries in the late 1950s and 1960s, the MNC came to be seen as a threat both to economic and political independence, a factor that was echoed in the development of dependency theory and structuralist approaches during this time (see DEPENDENCY THEORY; STRUCTURALISM).

See also:

capital flight; economic growth; globalization; interest rates

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ALISON M.S. WATSON

investment banks

Investment banks or merchant banks are all those banks providing investment-management services and services to the corporate sector. Their activities usually include issuing securities and underwriting securities issues, buying and selling securities, providing corporate advice on mergers and takeovers, managing investment and pension funds.

See also:

underwriting

L.S. TALANI

INVESTMENT PROMOTION AND PROTECTION AGREEMENTS (IPPAS)

see bilateral investment treaties (BITs)

invisible hand

ADAM SMITH saw the workings of an invisible hand in nature and in human society. His belief in the beneficent character of unintended outcomes follows Sir Isaac Newton and ancient Stoic natural theology, which had deeply influenced Smith. Smith's belief in divinely ordained natural harmonies was vigorously disputed in the nineteenth century; in the present day, however, the debate over the invisible hand has fundamentally changed. Certain extreme views that Smith never held have been attributed to him, in particular the belief that any free market outcome, even in the presence of vast differences in economic power and knowledge among those involved, will in some sense be superior to any outcome modified by social action. The invisible hand is here seen, as has been well argued by Heinz Lubasz in recent work, as the hand of the market itself (Lubasz, 1992: 37–56).

In the work of mainstream or neo-classical theorists, however, as distinct from the popular media, a notably more sophisticated and limited version of belief in the invisible hand 'of the market' has been offered. Here 'optimal' or 'efficient' results are claimed only for the ideal markets which exist (mathematically) in neo-Walrasian models of general competitive equilibrium. 'Optimality' or 'efficiency' of a certain kind is said to characterize the general equilibria in model markets composed of innumerable minute and powerless agents, who are endowed with 'nice' preferences and confront complete markets with PERFECT INFORMATION. Proofs of the (mathematical) exis-

tence of equilibria for such models have been put forward as the final formalization of something known intuitively to Smith.

To see the inappropriateness of an appeal to Adam Smith by either the apologists for unadulterated market outcomes in the popular media or the present-day devotees of neo-Walrasian general equilibrium models, a few words will be necessary.

The invisible hand in Adam Smith

First of all it should be noted that it was partly his deep respect for physical science in general and for Sir Isaac Newton in particular that led Smith to accept a belief (associated with Newton) in the argument from design. It is vital to see how vast the gap is between a physical scientist like Newton, who saw science as revealing a divine plan, and the scientists and philosophers of the first half of the present century, who so influenced the founders of neo-Walrasian theory. Neo-Walrasian economic theorists learned quickly that if they were to have any hope of being taken seriously by the logical positivist science and philosophy of the 1930s – or even by the later (watered down) logical empiricism of the 1950s – they must confine themselves to empirical statements and to what could be deduced from an axiom set by formalist mathematics. And they must always maintain a supposedly absolute separation between empirical statements and value judgements (Walsh, 1996: 180–4).

Thus the canonical neo-Walrasian GENERAL EQUILIBRIUM models were written, roughly in the 1950s and 1960s, in terms of a (now badly dated) philosophical analysis of scientific language which, if taken seriously, should have rendered Smith's texts all but unintelligible.

Smith's Newtonian-style argument, it must now be noted, required (among other things) a belief in a constant human nature. Human beings could then, in simply following this nature, be counted on to act in such a way as to implement a plan which had been no part of their intention. Baldly put, they would act as they had been designed to act. This is not a

proposition, surely, that would sit happily among the axioms of neo-Walrasian theory.

What was dear to Smith was the ancient Stoic concept of an intelligent author of nature, who had supposedly created a universe operating under natural law. Ian Simpson Ross, the author of the distinguished recent biography of Smith, argues forcefully that 'this variety of theism is an integral part of his approach to social phenomena' (Ross, 1995: 340). How crucial the felt presence of this invisible hand was to Smith can be seen vividly in his reaction to the possibility that an argument by David Hume had taken it away. Ross stresses that, if this belief of Smith's 'were taken away, Smith must have felt, then his whole theoretical apparatus was seriously damaged' (op. cit.).

Smith's doubts late in life concerning the invisible hand had been occasioned by an argument against the concept of design written by his dear friend Hume, a consideration which could only have increased Smith's distress. This sad and significant moment in Smith's last years is tellingly documented in Ross (ibid.: 401–2).

Smith's invisible hand versus the invisible hand 'of the market'

Given the utterly different system of beliefs from which it comes, it is hardly surprising that the workings of Smith's hand differ strikingly from those characteristic of what is known today as the invisible hand 'of the market'. Smith advocated, not the *laissez-faire* that is always inflicted on him, but what he called 'the system of natural liberty'. This system required laws that conformed to the (Stoic) concept of natural law and participants whose economic actions were moulded by long-term self-interest tempered by the (Stoic) virtue of prudence. In the 1970s and 1980s, on the other hand, Smith's name has been constantly invoked in support of a 'global' marketplace dominated by giant transnationals and 'hot' money. But Smith, of course, abominated monopoly power and condemned the doings of organizations like the *EAST INDIA COMPANY*. And he wished to restrain government largely because it

habitually granted monopoly powers. As has recently been noted, '[i]n Smith's vision the self-interested individuals ... are led by their natural inclinations to *channel* their investments so as to do the country as a whole the most good' (Lubasz, 1992: 40; emphasis in original).

Smith never held 'that society benefits no matter how private capital is invested' (op. cit.). On the contrary, like any of the great classical tradition of political economists, he regarded the diversion of labour and capital stock to the production of extravagant luxuries as the unforgivable economic sin (Walsh, 1996: 116–18). But it happened that in Smith's Britain the small capitalists, who were unwittingly performing the historic task of speeding the INDUSTRIAL REVOLUTION on its way, diverted most of the surplus that they obtained as profit into the productive employment of labour and stock in the further accumulation of capital. And, again in the conditions of the time, there was no reason for these little local capitalists to prefer the support of foreign industry to that of domestic. So Smith may be excused for seeing an invisible hand in these fortunate circumstances. The industrial revolution, of course, would later show its dark satanic side and Smith had an inkling of its growing social cost. But most of the worst came after his death.

The neo-Walrasian invisible hand 'of the market'

For the neo-classical school, the high point of their demonstration of the idealized workings of perfectly competitive markets was reached in the 1950 and 1960s. It consisted in the proofs of the (mathematical) existence and Pareto efficiency of equilibrium in complete intertemporal neo-Walrasian models. The original theorems are collected and elegantly presented by Gérard Debreu (1959), and were further elaborated and explained in KENNETH J. ARROW and Frank H. Hahn (1971). But, for the non-specialist, a most useful introductory sketch is Hahn (1982).

This latter paper of Hahn's is especially relevant here, since it is pellucid about some

major things that the neo-Walrasian models of their Augustan age (roughly 1950 to 1970) failed to achieve. Consistently with what he has done over many years in a series of scholarly papers, Hahn carefully details the many limitations of the canonical neo-Walrasian models. He then lays bare exactly why these limitations render vacuous the extreme claims of the free marketeers on behalf of real world markets. For him, these extreme claims possess no more intellectual merit than did the equivalent claims of the central planners (Hahn, 1982: 2, 20–1).

It should be noted that many of the changes made in neo-Walrasian theory since its gilded age, including changes that showed the inability of the original theory to offer a thorough-going defence of real world market outcomes, were made by successive neo-Walrasian theorists themselves.

The beneficence of pure market outcomes in the original complete neo-Walrasian models was in no small degree due to their assumption of PERFECT COMPETITION. This required (among other things) that uncertainty be eliminated, which was done by the complete markets hypothesis: it was assumed that every agent in the model must know the terms on which every good or service could be traded in every location, at every date and in every possible state of nature. As Hahn observes, this postulate is 'wildly at variance with the facts' (ibid.: 3). It is, however, indispensable for a number of the standard claims made in support of the invisible hand of the market. By the 1970s, the complete markets postulate was being given up by neo-Walrasian theorists.

Then the equilibria which had been proved to exist in the original complete neo-Walrasian models had been shown to possess a property highly valued by neo-classical economists: Pareto optimality or (more cautiously) Pareto efficiency. It has been argued with increasing force by a number of critics that this property was greatly overvalued (Walsh, 1996: 174–206). Leaving these charges aside for the moment, it must be noted that, as the structure of the original canonical neo-Walrasian models was successively weakened and modified, the equilibria which could still be proved to exist often

simply did not possess the property of Pareto efficiency, whatever its merits. In models with equilibria that are Pareto efficient, an equilibrium allocation of goods or services has the property that no other allocation of the goods and services between the agents in the model could be made which would be preferred by all of the agents. It had been a leading characteristic of the original complete neo-Walrasian models that they could be proved to possess equilibria, all of which could in turn be proved to be Pareto efficient.

Again, in the original neo-Walrasian models, all the agents (being perfect competitors) were assumed to take prices as beyond their control. But, as Hahn notes, they were also assumed to act entirely in their self-interest. In that case, why do they not seek MARKET POWER? Theorists had to adopt assumptions that made market power unattainable. But this entails that, with regard to 'size', each agent (including firms) must be reckoned 'as we would a single point in a collection of points on a continuous line – that is not at all' (Hahn, 1982: 6). It is scarcely possible to overstate how far a model with only such minute agents is removed from a real world of giant corporations and vast concentrations of highly volatile financial power. Hence the demonstration of the workings of the invisible hand of the market contained in the canonical neo-Walrasian models does not apply to economies in which the agents have any market power, which is to say that it does not apply to any real world economies. Where there is market power, Pareto efficiency is lost and agents find themselves in strategic situations, requiring the concepts of conflict and/or cooperation in games. Hahn concluded that 'one cannot invoke the classical theory of the invisible hand in dealing with economies in which agents have market power' (op. cit.).

Recently, models have been widely developed in which different agents possess significantly different information, as indeed they obviously do in the real world. These models allow a fascinating touch of real life to penetrate into general equilibrium modelling, but once again such 'equilibria' as exist have been found to

lack the canonical property of Pareto efficiency. Indeed, this is characteristic of many of the most interesting developments in recent work in the (broadly) neo-Walrasian tradition. The resulting models are closer to real life, but of little use to those seeking evidence of the successful workings of an invisible hand.

Since as long ago as the mid-1970s, younger theorists have been abandoning one after another axiom (explicit or implicit) that had been vital to the structural support of the imposing edifices of general equilibrium during its Augustan age, which was coming to a close. It was shown that existence of equilibrium could still be proved even if agents lacked the complete and transitive preferences with which they had been endowed in the original models, but which were quite evidently impossible for a real human being to attain (see, for example, Mas-Colell, 1974: 237–46; Shafer, 1976: 135–7; Gale and Mas-Colell, 1975: 9–15; Kim and Richter, 1986: 324–68). Even more strikingly, perhaps, it was shown that neo-Walrasian equilibrium could exist and (most perversely) even be Pareto efficient in a model economy in which a number of the agents did not survive the equilibrium because of lacking the necessities of subsistence.

As Peter Hammond has remarked, referring to joint work of his with J.L. Coles,

competitive equilibria can occur with a large proportion of the population below the margin of survival. Such equilibria are even Pareto efficient, because feeding the starving would require sacrifices from some of those whose survival is not at risk.

(Hammond, 1989: 211)

Part of the reason why theorists these days are using the euphemism 'EFFICIENCY' and not the customary term Pareto 'optimality' can be divined from Hammond's comment. One can also see part of the reason why theorists today, even if like Hammond they see themselves as being in the neo-Walrasian tradition, are less impressed than was once the case with the Pareto criterion and with equilibria that (as

now seldom happens) do happen to satisfy this criterion.

Awed by the imperial splendour of the original complete neo-Walrasian models in the 1950s and 1960s, many scholars in other fields (such as decision theory, philosophy, political science, jurisprudence and various social sciences) once accepted from neo-classical economic theory concepts of RATIONALITY, optimality, efficiency, maximization and so on, whose axiomatic development had been designed to fit into the *Pax Romana* of the neo-Walrasian competitive general equilibria of those times.

Hahn concluded the article which has been quoted here by expressing the fear that 'the non-fulfillment of the vastly exaggerated claims for the invisible hand' (Hahn, 1982: 21) will lead to a reaction towards unreason, in which the hand 'will be amputated forever' (op. cit.). As far as the popular media are concerned, we may indeed be headed for an age unfriendly to reason. For a number of younger scholars, however, in economic theory, philosophy, decision theory and related fields, the discovery that the criteria for calling an action 'rational' or an allocation 'optimal' are more complex – indeed more messy – than was once believed, has not led them to despair or to embrace the nihilistic side of POST-MODERNISM. They are living with the fact that *any* hand we could ever know can falter.

See also:

atomism; competition, economic role of; economic power; equilibrium theory; formal theory; game theory; market failure; neo-classical economics, critique of; rational choice; transnational actors

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VIVIAN WALSH

inward-looking development

According to 'inward-looking development' advocates, the market alone does not lead to the best allocation of resources in the national context and, also, does not necessarily meet domestic needs. R. PREBISCH and H.W. SINGER, who first developed and argued for the inward-looking strategy, based their view on the fact that the TERMS OF TRADE for the LEAST-DEVELOPED COUNTRIES (LLDCs) are deteriorating, to the benefit of developed countries. Hence, the government has to intervene by implementing policies to promote a structure of production capable of substituting imports for domestically produced goods. To achieve this, the government erects productive barriers, TARIFFS and QUOTAS on imports to make domestic production competitive and potential investments profitable. Following this policy, import substituting 'infant' industries are expected to emerge and, by putting aside imports, to subsequently contribute to the improvement of balance of payments.

The inward-looking development model was mainly implemented, with ambiguous results, in Latin American countries during the 1960s.

See also:

dependency theory; import substitution; industrialization strategies; structuralism

THEODORE PELAGIDIS

Iran-US Claims Tribunal

The Iran-US Claims Tribunal was established on 19 January 1981 to settle 'claims of nationals of the United States against Iran and claims of nationals of Iran against the United States', and 'official claims' of the two governments of a commercial nature that arose as a result of the Iranian Revolution (Article II(1) of the Claims Settlement Declaration).

The tribunal was established by the Algiers Accords, which comprise a 'General Declaration' wherein the United States pledged to refrain from interfering in the internal affairs of Iran and to return the Iranian assets that the US government had attached during the revolution, and the 'Claims Settlement Declaration', which provided for the settlement through arbitration of all outstanding claims of a commercial nature (3,839 in all). The intent of the tribunal was therefore to depoliticize the commercial settlements.

The Iran-US Claims Tribunal was an 'institutionalized arbitration' with a permanent secretariat in the Peace Palace at the Hague, but contained many aspects of '*ad hoc* arbitration' since it dealt with very diverse issues. It was also an instance of 'mixed arbitration', since it dealt with sovereign as well as private claims. Many aspects of the tribunal are of great significance to the development of international commercial arbitration. First, the Iran-US Claims Tribunal was the first to require decisions to be made public, thus increasing the amount of 'case examples' on record. Second, the tribunal utilized a modified version of the UNCITRAL Arbitration Rules because of their flexibility, thus demonstrating the manner in which such rules can accommodate the needs of parties with very diverse interests and political outlooks.

The tribunal has helped to clarify certain principles of law, such as *rebus sic stantibus* (changed circumstances). Most importantly, it has utilized aspects of 'transnational' or 'anational law' (such as generally accepted customs, practices and trade usages), thus giving admissibility to the application of a *lex mercatoria*, a

iron law of oligarchy

system of law autonomous of any municipal system.

See also:

United Nations Centre for International Trade Law (UNCITRAL)

JARROD WIENER

iron law of oligarchy

Oligarchy is a collective term that refers to a small group of individuals that control a larger group, organization or SOCIETY. The iron law of oligarchy, formulated by Robert Michels (1876–1936), refers to the argument that all organizations, even democratic ones, eventually become dominated by a small group of individuals. As an organization becomes larger, the need for administrative EFFICIENCY, and thus specialization, intensifies. As specialization within an organization increases, so does its bureaucratic and hierarchical structure. This results in a widening of the gap between the leaders and regular members. Over time, the leadership group will come to relish its power. To preserve its position of POWER, the leadership group will make decisions in accordance with its own interests.

See also:

bureaucracy

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J. ANDREW GRANT

Islamic Development Bank (IDB)

The IDB was founded as an international financial institution at the Conference of Finance Ministers of Muslim Countries, held in Jeddah in December 1973. The IDB's inaugural meeting took place in Rajab in July 1975. The bank was formally opened in October 1975. It aims to foster economic development in Muslim countries in accordance with the principles of the Shari'ah (that is, Islamic Law), forbidding usury (namely, not granting loans or credit for interest). The IDB assists member countries in the promotion of foreign trade, especially in capital goods; it provides technical assistance and extends training facilities for personnel engaged in development activities in Muslim countries in conformity with the Shari'ah.

MEHDI PARVIZI AMINEH

issue areas

Issue areas refer to the different topics or subject spheres in which political activity takes place. In the international relations (IR) context, for example, trade relations among states, specific conflicts between two or more states, foreign aid, alliances, arms control negotiations, are all different issue areas. The nature of the issue area will have an important effect on how policy within the area is decided. One striking finding in the literature has been that the actual actors involved in making policy and the motives of those actors vary widely depending on the issue area. As a broad example, it is often argued that the President of the United States has more autonomy of action within the area of foreign, as opposed to domestic, policy. The issue area concept illuminates how difficult it is to define POWER without reference to the scope, or issues, that are being addressed, since an actor's power will vary dramatically from one issue area to the next.

The behaviour of actors also differs very much from one issue area to the next. Within certain issue areas, cooperation among states may be exceedingly difficult to attain. Yet within other issue areas, customary behaviour may evolve; there may be convergence among actors' expectations regarding the rules, norms and decision-making procedures within the issue area. In other words, regimes may develop. For example, with respect to international tariffs and trade, member states of the WORLD TRADE ORGANIZATION (WTO) have stable expectations about what will happen if they lower their trade barriers to another state – RECIPROCITY. The MOST-FAVoured-NATION concept embodied in the WTO suggests that any restrictions imposed by a state on another state must similarly apply to all member states. Within this issue area, a regime has developed.

While specifying an issue area for analysis is intellectually satisfying, it does pose quite serious methodological challenges – particularly with respect to generalizability. For example, if one needs to specify scope and domain to assess power, cross-country comparisons of power are necessarily limited. Further, it is difficult to separate one sphere of activity from another; in many instances issue areas are tightly interconnected and interrelated. How, for instance, does one precisely differentiate between national security and economics? Can one even distinguish between international and domestic politics? It is extremely difficult to set boundaries around any particular issue area. In addition, perceptions of those boundaries change over time, as knowledge accumulates

about how interactions in one sphere affect activities in another.

See also:

functionalism; power; regime theory; spill-over

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PATRICIA A. WEITSMAN

Jamaica Conference

THE INTERNATIONAL MONETARY FUND (IMF)'s Jamaica Conference in 1976 was an attempt to adapt the international financial agreements established in 1944 at Bretton Woods, New Hampshire, to a changed world economic system. While that system worked well in its early years (see BRETTON WOODS SYSTEM), it came under increasing strain in the mid-1960s. Currency crises became more numerous and violent, and followed each other at shorter intervals. Convertibility of the dollar into gold was suspended on 15 August 1971 and the dollar was devalued in terms of most currencies in the Smithsonian Agreement in December 1971. After another devaluation in early 1973, general (though managed) floating of all major currencies started in March 1973.

Concern over the absence of rules governing currency movements resulted in the IMF Interim Committee's Jamaica meeting (January 1976) and the formulation of the Second Amendment of the Fund Articles of Agreement. The new system accepted the principle of non-fixed exchange rates and encouraged the international monetary order's central institution, the IMF, to take an active role in prompting national authorities to accept realistic exchange rates. It was anticipated that such a regime would avoid both the disruptions caused by the 'excessive' fluctuation of exchange rates and an undue rigidity of rates, which would hinder the international adjustment process. In this way, it was hoped the Jamaica reforms would produce a return to more orderly conditions.

ROBERT LOONEY

Japanese model

Attempts to identify a Japanese model of economic development have arisen as a consequence of Japan's rapid post-war economic recovery and its pattern of sustained economic growth, especially during the period of high-speed growth in the late 1950s and throughout the 1960s. Both Japan's industrialized competitors and less-developed industrializing economies have been keen to identify the lessons of Japan's economic success.

At the forefront of attempts to identify a Japanese model of economic development has been the work of Chalmers Johnson (1982, 1991). He has identified ten strategic structures which he contends have been intrinsic to the development of the Japanese economy. First, the Japanese financial system, a source of relatively low-cost and long-term investment capital for Japanese industry. Second, Japan's 'industrial groups', known in pre-war Japan as *zaibatsu* (financial cliques) and in post-war Japan as *keiretsu* (lineages) or *kigyo shudan* (enterprise groups), which proved to be relatively impervious to the effects of the international business cycle (until the 1990s). Third, the Japanese postal savings system, for recycling domestic savings into Japanese enterprises. Fourth, the *shingikai* (deliberation councils), the official forums through which bureaucrats, business leaders, technocrats and other representatives have formulated public policies. Fifth, the Tax System Investigation Council (*Zeisei Chosakai*), which has attempted to depoliticize Japan's tax system and to closely coordinate it with industrial policy. Sixth, the Japanese system of enterprise unions and relatively strike-free labour rela-

tions, which have promoted productivity and flexibility in the labour market. Seventh, the presence of cartels in important sectors of the Japanese economy, and the absence of anti-trust and anti-monopoly competition policies. Eighth, the research cartels (*kenkyu kumiai*) which have enabled Japanese firms to avoid the expensive cost of duplication of pre-competitive research and development. Ninth, the institutions, such as the Trade Council, which have gathered and provided low-cost market information and intelligence about both the domestic and overseas markets to Japanese firms. Tenth, the institutions, notably the MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI), which have been charged with the responsibility for formulating and implementing industrial policy (Johnson, 1991: 165–72).

Despite his having provided a detailed analysis of Japan's post-war economic development, Johnson has warned against the dangers of attempting to transplant institutional structures specific to Japan's particular history, society and traditions to another, entirely alien context. Thus, although he has acknowledged the possibility of another state adopting the same priorities as those encompassed by the Japanese model of development, Johnson has suggested that: 'Other nations seeking to emulate Japan's achievements might be better advised to fabricate the institutions of their own developmental states from local materials' (Johnson, 1982: 323).

Seven years of recession during the 1990s have challenged both the theory and practice of a Japanese model of economic development. The notion of a Japanese model, based on the administrative guidance provided to Japanese industry by MITI, has been challenged by a series of revisionist accounts of Japanese industrial policy (for example, Callon, 1995). More importantly, the collapse of the speculative 'bubble economy' of the late 1980s, and the failure of the Japanese economy to respond to no fewer than seven recovery packages launched by the Japanese government since 1992, have led some to question the validity of the Japanese model. For example, Adam Posen

has concluded that Japanese economic stagnation has been caused by mistaken and avoidable economic policies, namely it is a matter of political choice in which the Japanese model has no explanatory power. Posen therefore advocates a reassessment of 'the very idea that coherent "national economic models" are determinants of short-run macro-economics performance' (Posen, 1998: 149). Indeed, he asserts that 'the idea that there is an identifiable and stable Japanese model does not really apply' because large parts of the Japanese economy have never fitted the idealized pattern identified by Johnson *et al.* (Posen, 1998: 149).

See also:

Asian crisis; developmental state; Ministry of International Trade and Industry (MITI)

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SIMON LEE

Japanese telecommunications technology industry

The telecommunications industry is not only an important industrial sector in its own right, but is also of crucial importance to numerous other sectors and activities, such as electronic transfer of money and the ability to obtain access to information. In Japan, this sector has been dominated by a highly regulated regime which seems to favour large domestic carriers, such as Nippon Telegraph and Telephone (NTT) and Kokusai Denshin Denwa (KDD), while acting against international competitors. The United States government for one has been very active in trying to open the market to less discriminatory forms of competition.

The Japanese government, like that of Singapore, has identified the many advantages to be derived from a strong and innovative telecommunications industry, and has sought to encourage the industry. Telecommunications infrastructure underlies the competitiveness of all firms within the economy and the Japanese government has always tried to promote development of all sectors and all members of the country.

JOHN WALSH

joint ventures

A joint venture involves a firm, in collaboration with at least one other firm, setting up a jointly owned subsidiary in a foreign country. The partner firm or firms may be domestic- or foreign-owned firms. Each of the partners takes an equity stake (usually of equal amounts) in the newly created subsidiary. Joint ventures are often a way in which a foreign company can establish a physical presence in a foreign country when it is prevented from establishing a wholly owned subsidiary. The host country may insist on local equity participation, such that a joint venture is the only means of entry for the foreign firm. If the motive for entry to the foreign market is to produce goods for sale

on the local market, the foreign firm may be in a weak bargaining position. The alternative to supplying the foreign market through exports may confront the problem of high TRANSPORT COSTS and TARIFF OF NON-TARIFF BARRIERS (NTBs) which the foreign country puts on imports.

The joint venture constitutes a way in which a host country (particularly a developing country) can 'unbundle' the package of resources obtainable through FOREIGN DIRECT INVESTMENT (FDI). FDI involves a transfer of money capital, ownership, management and technology from the home to the host country. A developing country may wish to purchase some, but not all of these resources (for example, money capital and technology, but not ownership and management control). Through a joint venture, the host country may be able to ensure that more of the benefits of foreign investment flow into the local economy. It may also be better able to prevent the foreign firm from engaging in transfer-price manipulation (see TRANSFER PRICING), which is damaging to the local economy.

Further reading

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NIGEL GRIMWADE

justice

The word 'justice' has several connotations: the most important ones are (a) the ideal of justice as fairness (in moral and political theories, but also in popular perceptions); (b) the system of laws and norms at a particular time and place, and (c) the 'fair' allocation of resources in a

SOCIETY (social justice). The difference between these three concepts is the role that the law plays in each one of them. Under the first meaning, the law should achieve a level of substantive justice (for example, everyone should receive what they deserve according to their actions), usually in compliance with the rules of a shared moral code. Under the second meaning, the law is an instrument of social control which emphasizes procedural fairness. Under the third meaning, the law should achieve a satisfactory degree of formal and substantive EQUALITY, and should ensure fair distribution of resources and equal opportunities.

Legal theory (or jurisprudence) examines the interrelationship between all the above meanings of justice and especially the relation between moral and legal theory; the influence of both on the legal system; the critique of the legal system from different legal, moral and political perspectives; legal philosophy and the interdisciplinary approaches to justice (law and economics, sociology of law and so on). and last, but not least, political theories on justice.

Here we will not be discussing philosophical theories elaborating on the meaning and nature of corrective justice and its relation to morality, nor on the use of law as a medium of social control. We will examine more closely the problem of economic justice, that is, the modern theories on liberty and equality, EFFICIENCY and social justice, as developed by John Rawls, Robert Nozick, FRIEDRICH AUGUST VON HAYEK, Richard Posner and the communitarians (see COMMUNITARIAN VALUES).

Modern theories of justice

Today's mainstream political philosophy and theories of justice are based on three underpinnings: (a) The work of Aristotle on justice remains not only extremely influential, but also controversial, since it is considered to be a basis for both communitarian neo-Aristotelian theories of justice (the most likely successors) and for individualistic (almost egoistic) theories, such as the objectivist Nietzschean philosophy of Ayn Rand. Aristotle's most important

methodological (and substantive) contribution was his distinction between corrective and distributive justice. (b) The 'social contract' theories which rationalize their classical liberal doctrines with the famous social contract myth: democratic and liberal society is supposedly based on the free choice of rational and autonomous agents. (c) Utilitarianism, the philosophy which aims at the maximization of society's WELFARE (as Jeremy Bentham aptly put it, 'the greatest happiness for the greatest number'): the influence and power of utilitarian ideas has been the major force behind the invigoration of political philosophy, especially after the wholehearted adoption of utilitarianism by NEO-CLASSICAL ECONOMICS. Most contemporary theories begin as a reaction (usually critical) to utilitarian ideas.

John Rawls' theory of justice

Rawls attempted to overcome the power of utilitarianism by offering an alternative theory, which would be individualistic without compromising society's welfare. This led him to a theoretical construct which defined the discussion on the subject for decades to come. Rawls returned to the ideal of the social contract as the most satisfactory account of the fundamental rights and liberties of citizens as free and equal persons. For Rawls, each person possesses inviolable basic rights, founded on justice, that even the welfare of society as a whole cannot override. However, the protection of this core of rights does not guarantee the welfare of society. Social inequality should be alleviated (through state intervention) to the extent that (a) the basic core of rights remains intact and (b) economic efficiency, which is necessary for the welfare of society, is not severely wounded.

But what is the equilibrium point where the three objectives (liberty, equality and efficiency) are satisfied in the best possible combination for general welfare? Rawls answers with the now famous device of the 'veil of ignorance'. Fair is what most people would recognize as fair under a veil of ignorance as regards their own status (ethnicity, race, sex,

talents and so on) in a future society. Without knowing their future physical and social properties in such a society, and thus from an impartial standpoint, what should be the rules governing this society? What are the rules that completely impartial people would devise, provided that they are rational (that is, self-interested) and decide under uncertainty?

According to the Rawlsian theory of justice as fairness, the collective choice of individuals in such conditions would be to maximize the utility of the least advantaged (maximin theory). This led to the following principles:

First Principle: Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all.

Second Principle: Social and economic inequalities are to be arranged so that they are both (a) to the greatest benefit of the least advantaged and (b) attached to offices and positions open to all, under conditions of fair equality of opportunity.

These principles are accompanied by two priority rules. According to the first rule (priority of liberty), the principles of justice are to be ranked in lexical order and therefore liberty can be restricted only for the sake of liberty. Thus a less extensive liberty must strengthen the total system of liberty shared by all, and a less than equal liberty must be acceptable to those with the lesser liberty. According to the second rule (priority of justice over efficiency and welfare), the second principle of justice is lexically prior to efficiency and wealth-maximization. Thus, an inequality of opportunity must enhance the opportunities of those with the lesser opportunity.

The general conception in Rawls' words is that: 'All social primary goods – liberty and opportunity, income and wealth, and the bases of self-respect – are to be distributed equally unless an unequal distribution of any or all of these goods is to the advantage of the least favoured' (the difference principle – 1971: 303). This essentially means that inequality is accep-

table as an incentive which can motivate the least well-off.

There are many problems in Rawls' construct, pinpointed by the hundreds of writers who have discussed, criticized, refined, advanced or dismissed his theory. To mention some of them, his social contract myth is just that, a myth; there is no empirical proof for his conclusions; the principles are the principles that Rawls, and not society-at-large, sees as fair (in fact, there are contrary empirical studies); the lexicographic priority is problematic; there is no discussion of desert or merit in relation to advantage; the account of chance attributes is unconvincing, and so on.

However, the main reasons for the allure of Rawls' theory (despite its utopian premise and his debatable conclusions) are his highly successful combination of utilitarianism, individualism and **EGALITARIANISM** in an unparalleled construction, and the power of his parable.

Libertarian attacks on social justice

Robert Nozick is a fierce opponent of utilitarianism, much more so than Rawls. Accordingly, he is completely against any state intervention based on comparisons of utility and welfare. For Nozick, a minimal state is only necessary for the protection of the inalienable individual rights (especially property rights). Like Rawls (and Locke, his intellectual predecessor), he believes that the state should not interfere with the basic individual rights and freedoms. However, he does not accept the idea of equal opportunity in his system of justice. According to Nozick, only the ownership which is based on entitlements derived from original acquisition, free exchange of resources or lawful transfers is justifiable. Any other conception of justice, based for example on desert, is 'patterned' and antithetical to his theory of justice as entitlement. Thus there are no just distributions of entitlements but only just procedures for the creation and transfer of entitlements. This is also the problem with Nozick's theory: he treats entitlements as

exogenous and the broader problem of past injustices rather superficially.

F.A. von Hayek views social justice as a 'mirage', an elusive concept, based on an erroneous view of the market. For Hayek, the market cannot be characterized as just or unjust, since the market is similar to a natural phenomenon. To characterize the outcomes of a market process (especially inequality) as just or unjust is pointless. The market is the superior type of economic organization in terms of efficiency and thus welfare. The unequal distribution of wealth in a market system is the best possible distribution even for the least advantaged, who will, in the long run, be worse off under any other distribution that would distort the market. Hayek's affinity to utilitarianism is obvious, but he is also very close to Rawls' premises (especially the difference principle). However, the basic problem in his thesis is his perception of the market as beyond correction (no doubt owing to his Austrian economics – see AUSTRIAN SCHOOL).

The communitarian critique of liberalism

The communitarians are the most diverse group of scholars in the recent history of political philosophy. Some of them are conservative and some others progressive, some are former liberals or libertarians and yet others former new-leftists. The unifying theme in their approach is their critique of LIBERALISM (including libertarianism) as the social ill of advanced industrial societies. They identify liberalism with nihilism, immorality and irresponsibility. They hold liberal ideas responsible for family breakdowns, crime, consumerism and moral decline. They accept only societal formulations of the good and hence reject the validity of the social contract theory, since, for them, there is no pre-social concept of the individual. Thus, liberalism's concept of individualism is theoretically flawed, but also empirically indefensible.

The problem with the communitarians is not their critique of liberalism (which is most often well-grounded), but their normative proposals (that are quite colourful due to their diversity).

Some of their recommendations seem to work (like the 'broken windows' theory by James Wilson, which brought down the crime rate in New York City). However, most of their proposals are quite conservative and often sound desperately passé.

Richard Posner's pragmatism

The RATIONAL CHOICE revolution in the social sciences exerted its greatest influence on law. Law and economics (L&E) is one of the most successful PARADIGMS in the history of social science and its leading proponent, Judge Richard Posner, has managed to transform an epistemological paradigm into a theory of justice, indeed the most controversial one since legal positivism. Posner undertook to overcome the three basic problems of utilitarianism (impossibility of interpersonal comparisons of utility, authoritarianism and moral monstrosity) with the concept of wealth maximization (a concept with a utilitarian premise, but based on the economic approach as the study of rational choice not limited to the market) and the liberal concept of consent.

For Posner, wealth maximization provides a more solid basis for an ethical theory than utilitarianism. The difference is that wealth maximization, unlike utilitarianism, promotes not 'happiness'- or 'utility'-maximization in general, but the maximization of social welfare. The latter does not use subjective valuation as its measurement, but the 'value in exchange' – that is, the value of the good to its marginal purchaser (its market price). Efficiency is an adequate concept of justice that can plausibly be imputed to judges. However, Posner does not deify consent and efficiency (especially in recent writings). Posner's emphasis on efficiency is due to analytical convenience: it enables issues of resource allocation to be discussed separately from issues of distribution. Posner's ethical norm manages to include both utility and consent (essentially unifying Kantian and utilitarian approaches), by recognizing the limitations of markets (and thus defective consent) and by using a more objective criterion than utility.

Posner's theory is germane to Rawls' theory (for both, what is relevant is not the utility of individuals but their resources), but with two essential differences: Posner opts for the maximization of the expected utility rather than Rawls' minimization of expected disutility, and Posner's theory is more economically sophisticated than Rawls'. However, the basic shortcomings of Posner's theory are that it is counter-intuitive and vulnerable to a charge of naturalistic fallacy: it sounds morally reprehensible even to those who accept it under a different name. Posner's theory has sparked great controversy in American legal theory. Posner himself has departed from his initial unequivocal stance, drifting towards a pragmatic (instrumentalist) theory which, in his words, 'emphasizes the primacy of the social over the natural' (1995: 7). This is a great departure from his earlier beliefs, which has led him to a liberal pragmatism that views law as a system of social control, a weapon for more effective social action.

See also:

exploitation; individualism, methodological

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ARISTIDES N. HATZIS

K

kaizen

The competitive success of Japanese corporations in global markets has been underpinned both by the organization of capitalism in Japan, which differed from the individualistic market model, and by innovative management systems. The system of 'continuous improvement', or *kaizen*, lies at the heart of the latter. The message of *kaizen* is that not a day should go by without some kind of improvement in systems and procedures being made somewhere in the company. *Kaizen* seeks to create an innovation culture grounded in the principle that all employees should collaborate in problem-solving processes. *Kaizen* improvements are being continuously implemented in Japanese companies. Managers spend up to 50 per cent of their time involved in *kaizen*.

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ROB LAMBERT

Kaldor, Nicholas (1908–86)

Nicholas Kaldor was one of the foremost economists of the twentieth century, making fundamental contributions to WELFARE ECONOMICS, capital theory, TRADE THEORY, KEY-

NESIAN ECONOMICS and the theory of growth and income distribution. He was born in Hungary and came to the London School of Economics (LSE) as a student in 1927. On graduation he was appointed to the staff and, against the prevailing orthodoxy of the LSE, became one of the first converts to the Keynesian revolution in 1936. During World War II, while the LSE was evacuated to Cambridge, he came into direct contact with the CAMBRIDGE SCHOOL of economists and was appointed to the staff there in 1949–50 as a Lecturer in Economics and a Fellow of King's. In the 1950s, he was one of the architects of the post-Keynesian school of economists (see POST-KEYNESIAN ECONOMICS) including Joan Robinson, Richard Kahn and Luigi Pasinetti, and later in the 1970s led a worldwide intellectual assault on the doctrine of MONETARISM.

Apart from his contributions to economic theory, he was also an accomplished applied economist and a distinguished public servant, acting as tax adviser in several countries overseas and as special economic adviser to three UK Labour Chancellors of the Exchequer between 1964 and 1976. A peerage was conferred on him in 1974 and he was active in the House of Lords until his death in 1986.

He also served on several government commissions, including work for the two Beveridge Reports on social insurance and full employment in 1942 and 1944, respectively; the Royal Commission on the Taxation of Profits and Income (1951–4), and was research director of the Economic Commission for Europe (1947–9).

Many of his major contributions to economic science are included in his nine volumes

of *Collected Essays* published between 1964 and 1989.

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ANTHONY P. THIRLWALL

Kant, Immanuel (1724–1804)

Immanuel Kant was born and died in Königsberg (modern Kaliningrad) in eastern Prussia. During his long career at the University of Königsberg, first as an instructor and then as Professor of Logic and Metaphysics from 1770, he wrote on a wide variety of subjects including astronomy, geography, theology and physics, although it is for his work in ethics, epistemology and political thought that he is chiefly known. Throughout these works, Kant was deeply influenced by his Christian Pietist beliefs. Despite a long and distinguished writing career, Kant's writings on political thought were almost exclusively composed in later life. His most famous work on international issues, *To Perpetual Peace*, was not published until 1795 when Kant was already seventy-one, while his discussion of right in inter-state politics was published as part of his *Doctrine of Right* in 1797.

Kant's arguments on political and economic issues, like those of most complex and nuanced thinkers, have been open to wide misrepresentation. He has been classed as the advocate of a pacific union of democracies when in fact he was quite suspicious of democratic government (although he was a fairly enthusiastic supporter of the Jacobins during the French Revolution). Kant's championing of cosmopolitanism and criticisms of war often lead him to be classed as

an opponent of REALISM, but his equally emphatic championing of the role of the state and his view of human nature as limited and selfish allow him to be interpreted as a realist on occasions. Similarly, Kant's support for free commerce may, at face value, put him in the same camp as the neo-liberals (see NEO-LIBERALISM). The problem here is that Kant actually abhorred the selfish immorality of commerce, but saw it as being preferable to the selfish immorality of war.

Kant's interpretations of political economy, like much of his thought, spring from his metaphysics. Certainly, the argument of *To Perpetual Peace* only makes sense when read in the light of the *Groundwork of the Metaphysics of Morals* (published ten years earlier). In the *Groundwork*, Kant attempts to create a science of ethics by working back from common-sense views of morality towards *a priori* arguments. During this exercise, Kant argues that humans have both a rational and a natural side, and that consequently they obey both the laws of nature and the laws of reason. Reason links humans to the divine (God being infinitely rational), but human reason is only finite and therefore flawed. Humans, then, can control the extent to which they either obey the deterministic laws of nature or use their reason to free themselves to make their own rationally determined laws.

In *To Perpetual Peace*, Kant extends this logic to the realm of inter-state politics. Since war does not decide issues in relation to *a priori* principles of right, it stands to reason that war stands condemned by reason. To will violence on someone else is to rationally will it upon yourself, which is irrational. On the other hand, Kant points out, war has utility under the laws of nature, since it has been the means of spreading people throughout the world. This process is now complete, however, and since nature requires that all animals develop their capabilities to the full, it follows that humans must now develop their reason in order to end war. Having established the philosophical basis for the condemnation of war, Kant goes on to construct a reasonable procedure for the development of perpetual peace. Since, Kant

argues, war does not benefit most of the productive members of a society, it follows that a republican regime (one with a division of powers that prevents the domination of any one group in society) will be less inclined to go to war. Similarly, a collection of republican regimes will form a pacific union between themselves, which Kant predicted would grow into a federation of independent states within which war would be permanently abolished and where commerce would become the vehicle for human selfishness. In *The Doctrine of Right*, Kant makes this federation between states a moral imperative, although he is at pains to point out that this is a topless federation that brings together free states and that each state has the freedom to leave it if it so desires.

What is interesting about Kant's argument is that, while he has divided natural laws from laws of reason, and while it is clear that he favours the latter, his road to perpetual peace involves the careful intertwining of both sets of law. Reason condemns war, but it is nature, until now the cause of war, that works in the interests of reason in order to fulfil a moral imperative dictated by reason. Similar complexities can be found in Kant's other political works, where (for example) the unfolding of history leads to the fulfilment of reason, but only because of the push of natural selfishness and, even, because in the very act of believing in progress (a voluntary activity) we make it inevitable. Kant's intellectual afterthought about the role of reason in creating a cosmopolitan and unified history would later be taken up and developed by Hegel in his *Philosophy of History*, where reason is given a far stronger role than the one envisioned by Kant.

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LUCIAN M. ASHWORTH

Kautsky, Karl (1854–1938)

Karl Kautsky was the most significant interpreter of Marxism after the death of KARL MARX and Friedrich Engels, and chief theorist of the German Social Democratic Party (SPD). He defended the theories of SURPLUS VALUE, CAPITAL CONCENTRATION and class polarization against the criticisms of Eduard Bernstein and the 'revisionists', but rejected ROSA LUXEMBURG's call for revolutionary action and became a leading critic of Bolshevism after 1917 (see BOLSHEVIK). Kautsky also made a significant contribution to theories of class consciousness and IMPERIALISM.

Kautsky studied history and natural sciences at the University of Vienna in the 1870s and became active in first the Austrian and then the German socialist movements. During the persecution of the SPD (1878–90), together with Bernstein, he propagated Marxism through clandestine journals; in 1883 he founded the magazine *Die Neue Zeit* (*The New Age*), an international forum for Marxist debate. His prognosis of capitalist development was hugely influential, not only within German Social Democracy but throughout the world. When he died, half a million mourners attended his funeral.

Kautsky's Marxism was derivative but not crude. He realized that the theory of surplus value said nothing about absolute wage levels, but rather that workers would never gain the full value of their labour as long as they were forced to sell their labour-power to the capitalist. The impoverishment of the proletariat was a continuing process, but did not mean that wages were falling in absolute terms. Trade-union struggle might improve the living

standards of workers, but improvements had to be seen in the context of higher productivity and an intensification of labour. These processes meant that the worker could receive a smaller percentage of the value of his labour at the same time as wages rose: using the Reich tax statistics, he demonstrated that profits and higher incomes were rising at a faster rate than wages and lower incomes. Thus impoverishment was a relative concept.

The SPD theorist also argued that economic crises were an inevitable feature of a mode of production in which production was for profit not use (that is, capitalism), not least because what he first called COLONIALISM and later IMPERIALISM translated competition onto a global scale, entangled European capitalism with colonial revolt and brought the threat of war. (After 1911, his position did change: the theory of 'ultra-imperialism' claimed that war had become dysfunctional for capitalism, that a process of international CARTELIZATION was taking place, which would continue to involve the exploitation of the European proletariat and colonial peoples, but which would not lead to armed conflict.)

Recurrent crises produced an increasingly concentrated economy and a more polarized class structure, as small producers went to the wall. For Kautsky, this was a crucial issue: if the working class were not increasing in size (see CLASS, WORKING), then the strategy of proletarian isolation, which was central to his politics, would make no sense and the prospects of successful proletarian revolution would be thin. Hence, he denied that the survival of the peasantry negated class polarization. He agreed that the law of capital concentration operated less efficiently in agriculture than in industry. Peasants had survived, but they had survived at a cost. Faced with falling agricultural prices, itself a consequence of agrarian modernization, many peasants had been forced to take up ancillary employment in domestic outwork or rural factories. Their survival entailed huge levels of self- and family-exploitation. Thus the hold of capitalism was increasing, despite peasant survival. In any case, the existence of a peasantry did not

contradict the thesis of class polarization because peasants did not constitute a class, for they were incapable of independent political action. They veered from one position to another in their political allegiances, but were becoming increasingly reactionary, at least in Western Europe. (Interestingly, he was arguing from the early 1890s, and especially from 1902, that the Russian peasantry did constitute a source of revolutionary potential.)

Kautsky was aware of the growth of the 'new middle class' of white-collar workers, but he did not believe that their existence rendered obsolete the idea of an increasingly polarized class structure: this group was no more capable of independent politics than the peasantry. It would line up behind either the bourgeoisie, in the case of company directors and bank managers, or, in the case of clerks who were facing automation and increased competition for jobs, with the proletariat. In Kautsky's opinion, the labour movement was to rely on its own energies for another reason: the middle class (see CLASS, MIDDLE) was becoming less liberal and increasingly reactionary, most obviously in Germany but even in Britain at the time of the Boer War. In an age of IMPERIALISM, it increasingly looked to the state to defend its interests at home and abroad. Hence class antagonism would become more and not less bitter, and the victory of socialism would require the 'dictatorship of the proletariat'.

It became clear in his polemic against LENIN after 1917 that Kautsky did not understand the concept of proletarian dictatorship to involve violent repression; this had always been his position. Even in the 1890s, he believed that democracy constituted the most fruitful soil both for the development of the socialist movement and for proletarian rule after the revolution. Where he differed from Bernstein was in believing that a revolution was necessary in semi-autocratic Germany to bring about democratic rule. His call for proletarian dictatorship turned out to be nothing other than another plea for working-class self-reliance, not a commitment to any specific revolutionary tactic.

Kautsky's critique of capitalism was accompanied by an almost complete silence on tactical questions. He not only rejected 'Blanquism', which he equated with Leninism, but also Rosa Luxemburg's advocacy of a mass strike. The SPD was to organize itself for revolution, but not to organize revolution itself. He believed a dictatorial regime could never survive against a class with 'economic necessity' on its side (a point he made about the Wilhelmine Reich, Bolshevik Russia – which he dismissed as a dictatorship 'over' the proletariat – and even Nazi Germany!). This passive radicalism was a product of the non-revolutionary situation in Germany before 1914 and also of a Marxism ignorant of Hegel and strongly influenced by Darwin. Though Kautsky distinguished between social and natural laws, he nonetheless believed that the development of society was law-governed. Though he argued that the proletariat required the intervention of revolutionary intellectuals and a revolutionary party to overcome the economism and sectionalism of its daily struggles and gain revolutionary class consciousness (an argument Lenin borrowed expressly from the German theorist), he nonetheless talked constantly of 'natural necessity'. 'Economic necessity' was the decisive factor in history. Revolution and socialism remained 'inevitable'. Economic laws could not be overcome by human artifice (and hence the Imperial regime, Bolshevik rule and Nazi terror would ultimately collapse without the need for armed struggle).

Kautsky's biting critique of existing society inspired the younger Luxemburg and Lenin around the turn of the century, but at a time of revolution at the end of World War I, its silence on tactics proved fatal. During the conflict Kautsky emerged as a leading critic of the war and of the German government, and he was again author of the SPD's 1925 programme. By this time he had moved to Vienna and the more congenial world of Austrian Social Democracy, which had not split into democratic and communist wings. *Anschluss* in 1938 caused him to flee to Holland, where he died, reviled by the Bolsheviks but respected by many who

had tried to steer a middle course between reformism and Bolshevism.

See also:

Bolshevik; Marxism Leninism; Menshevik; social democracy

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DICK GEARY

Keidanren

Japan's primary business interest group, the Federation of Economic Organizations (*Keidanren*), was formed in 1946. It has served as a conduit for money from firms to political parties, usually the Liberal Democratic Party. An ardent supporter of market-friendly policies, it has a long history of opposing legislation viewed as anti-business (for example, early environmental protection laws).

JONATHAN R. STRAND

Kennedy Round

The Kennedy Round (1964-7) was the sixth multilateral trade negotiation or round held under the auspices of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT). The US TRADE EXPANSION ACT (1962) granted the US President authority to reduce TARIFFS up to 50 per cent, contingent on reciprocal concessions from Europe, and prompted the new round which resulted in a 35 per cent weighted average tariff reduction. The Kennedy Round resulted in significantly less liberalization of trade in agriculture.

Departing from previous GATT rounds, the Kennedy Round introduced a linear formula for tariff reductions among the major industrialized trading states. While previous rounds had used item-by-item negotiations, the linear formula called for across-the-board tariff reductions limited by subsequent exceptions which underwent a process of challenges and

justifications. The need for parties to achieve reciprocal concessions limited the application of linear approaches.

While previous rounds had addressed individual non-tariff measures (NTMs), during the Kennedy Round NTMs arrived on the GATT agenda as an issue under study. Member states submitted lists of NTMs which they wanted altered. These included internal taxes, quantitative restrictions, technical standards, administrative procedures and customs valuations. The use by the United States of an 'American Selling Price' to determine tariffs on imports (particularly chemicals) was negotiated in the Kennedy Round. The agreement on the American Selling Price was aborted when the US Congress refused to make the necessary changes to US trade law. A uniform code for anti-dumping procedures was also drafted.

The Kennedy Round marked the introduction of a section on 'Trade and Development' to the GATT charter. Developing countries were explicitly released from expectations of reciprocal tariff concessions and special consideration was paid to trade preferences for developing countries. A Tropical Products Group was created and tariff concessions on tropical products were accelerated.

See also:

Dillon Round; Geneva Rounds; Tokyo Round; Torquay Round; Uruguay Round

JANE WINZER

Keohane, Robert (1941-)

Robert Keohane can be seen as one of the masters of the discipline of international political economy (IPE) as international relations (IR) as a whole emerged from the realist dominance in the latter part of the COLD WAR. He was one of the first theorists to challenge the monopoly of the state in international theory and to suggest that non-state actors could be as important as – or even more important than – the state in determining

patterns of cooperation and conflict. He is also widely known for his work on the evolution of international organization (IO) and has played a key role in all the major debates in IR of the late-Cold War and of the current epoch. He has done so by entering into – and to a large extent stimulating – the debate about what actors or factors should be of interest to students of IR. He has taught at Swarthmore, Stanford, Brandeis, Harvard and Duke universities.

Keohane's first major contribution came in his *Transnational Relations and World Politics* (Keohane and Nye, 1971). This asked the basic questions that have continued to preoccupy him: what is the effect of transnational relations on governments (and in particular American governments) and on IOs and world politics in general? He followed this up with *Power and Interdependence* (Keohane and Nye, 1977) which elaborated the above ideas into a new approach called 'complex interdependence' with the institutional manifestation of this in 'ISSUE AREAS' and 'international regimes'. This was an approach which retained the state as the main actor, but which acknowledged the role of other actors and asked why specific sets of 'norms, rules and procedures' got incorporated into given regimes, how these regimes change in various issue areas and how leadership (hegemonic or non-hegemonic) affects regime outcomes. In short, he was interested in why cooperation came about and persisted (1989a).

In his initial musings about regime theory (RT), Keohane posited the importance of a single state as initiator, as had seemingly happened with the *PAX BRITANNICA* of the nineteenth century and the *PAX AMERICANA* after 1945. His thinking, in line with much self-analysis in the United States in the years after the Vietnam War, led him to reflect on the importance of a state 'hegemon' in the foundation of regimes. regimes that were said to be institutionally organized in the form of IOs. In *After Hegemony* (1984), he asked what might be the consequences of a decline of American power for the institutions that such power had engendered.

He emphasized the importance of economic factors in international political cooperation. Because of these concerns, Keohane can be

clearly identified as being part of a long tradition of liberal internationalism, one that sees international structures as intimately linked to the fate of strong states. He took this further by being an early critic of the notion of 'HEGEMONIC STABILITY' (Keohane, 1983), using RATIONAL CHOICE theory to show how governments use regimes to obtain international cooperation they cannot secure alone. In this paper, he also referred to Robert Jervis's idea of 'reciprocation' (also Keohane, 1983), a notion that was to motivate much of his work on regimes in the mid- and late-1980s (as in a 1986 essay reprinted in Keohane, 1989a).

Keohane is not an uncritical advocate of liberal internationalism supported by liberal states. He has also demonstrated his understanding of the limits of classical realist thinking (such as about power and rationality) and a clear advocacy of normative thinking about IR in *Neorealism and Its Critics* (1986). NEO-REALISM was identified by Keohane with the more rigorous and structural version of realism advocated by Kenneth Waltz in his *Theory of International Politics* (1979). Keohane's argument with Waltz was not with his systemic approach, but rather with his inability to explain change, which Keohane said had to be done by a more penetrating analysis of economic factors and of the internal parameters of state power and international institutions. Keohane has emphasized that he 'do[es] not identify with neorealism' (1989b: 252).

It has, correctly, been argued that Keohane has not rejected the idea of the state as a valid historical model, while other theorists (like John Burton) reject the idea that the state was ever more than one actor among many on the world stage. Some historical sociologists (like IMMANUEL WALLERSTEIN) would also claim that CAPITALISM, not the state, has played the major role in determining the shape and evolution of the international system over the last several hundred years. Keohane still accepts the centrality of the state, but he has modified both realist and liberal assumptions considerably in his 'LIBERAL INSTITUTIONALISM', with its emphasis on 'formal and informal rules' embedded in institutional structures as

well as the 'material forces of world politics and the subjective self-understandings of human beings' (1989a: chap. 1). He has refined this institutional perspective by saying that it is, 'like realism ... utilitarian and rationalistic' (1995). However, unlike realism, 'despite the lack of common government in international politics, sustained cooperation is possible ...'. This perspective allows for the inevitability of conflict between and within states, but posits that states use IOs to facilitate negotiations between them. IOs in turn 'can affect the strategies states choose and the decisions they make' (Keohane and Hoffmann, 1993: 4–5).

Both before and after the end of the Cold War, his views have been attacked in some quarters for being too conservative and supportive of the status quo. His prominent position in the IR community has, perhaps inevitably, made him a target of the young wolves. Robert Cox (1981) has, for example, accused him and others of the IR establishment of being mere 'problem-solvers', alleging that what was essential was a more 'critical' approach to IR, although both Cox and Keohane share a belief in the importance of both institutions and material forces in IR. A 'critical' approach would assert that it could provide a better and more dynamic view of hegemony as an interplay of power, ideas and institutions and put much more emphasis on class and capitalism as a vector of change than state structures or IOs.

Keohane has conducted spirited counter-attacks against such thinking, while engaging with it nonetheless. For example, he sees 'empirical' and 'post-modern' feminist approaches to IR as either indiscriminating in their attacks on the 'patriarchal state' or epistemologically flawed. The latter criticism is more serious for Keohane in that he believes such post-modern thinking will of necessity lead to the 'fragmenting [of] epistemology, denying the possibility of social science' (1989b). Keohane has also replied (1988) that post-modernists do not in fact have any 'research programme' and that they are thus indulging in nihilistic reflection. He has also proved capable of taking notice of some

'critical' approaches, such as feminism. However, he defended (1989b) the idea that 'stand-point feminism' might prove an excellent tool to further investigate themes that he has studied for most of his career, especially the state, SOVEREIGNTY and reciprocity. Although, as he himself put it, this contribution met first with 'silence' and then post-modern irony, he has not been afraid to confront the dichotomies that some feminists allege are central to the 'gendered discourse' of (male) IR (1998).

Keohane has his ardent defenders and not uncritical followers, like Andrew Moravcsik. Craig Murphy implies that Keohane might be better summed up as a 'critical' liberal internationalist (Murphy, 1994). This term is used to define thinkers who reassess the liberal tradition with each generation, as did the post-war Keynesians. As Murphy says, this liberal tradition 'assumes that much of human action arises from the rational pursuit of self-interest', an assumption that would presumably be countered by the (neo-Marxist or Gramscian) critical thinkers in IR as misunderstanding the forces of historical change or the benevolent intentions of the hegemonic powers. Murphy counters that Keohane is in the central tradition of Kant and his followers, 'who have understood the power of international institutions in much the same way that Keohane has explained it to us today.' For Murphy, Keohane is an advocate of an 'ethical hegemony' that others cannot see in the IOs or states that dominate international politics.

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ANDREW WILLIAMS

Keynes, John Maynard (1883–1946)

John Maynard Keynes was born in Cambridge on 5 June 1883, married the Russian ballerina Lydia Lopokova on 4 August 1926 and he died at Tilton in Sussex on 21 April 1946. He is an extraordinary figure in the history of the twentieth century. It is an understatement to

say he was a man of many parts. He was adviser to the British government during both World Wars, a key figure on the inter-war Macmillan Committee, Bursar of King's College, Cambridge (during which time the college endowment soared), editor of the *Economic Journal* (1911–37), on the board of several investment and insurance companies, a speculator who increased his personal wealth from £16,000 to over £400,000 (the equivalent of over £10 million today), the first chairman of the Arts Council and a member of the Bloomsbury set. Above all, he was an economic theorist and practitioner who did more than any other person to shape the international economy of the post-war period. First, he encouraged governments in this period to accept responsibility for tackling unemployment, notably through the influence of his major work, *The General Theory of Employment, Interest and Money* (1936). Second, he advised governments and influenced public opinion through a steady stream of popular writing on the problems of the world economy, culminating in his direct role in negotiating the key post-war institutions of the world economy established by the agreement at Bretton Woods in 1944 (see BRETTON WOODS SYSTEM).

Institutions of the international economy

Throughout the inter-war period, Keynes was concerned with the problem of deflationary bias in an international financial system that forced the burden of adjustment on to deficit countries. The British return to the GOLD STANDARD in 1922 at the pre-war value epitomized the problem. British goods were uncompetitive at this rate and the operation of the Gold Standard put pressure on Britain to adjust internal prices downwards. The stability of internal prices was sacrificed for the purpose of maintaining the external value of the currency and the result was a high level of unemployment as wages and prices were slow to respond. Earlier, Keynes had cautioned for similar reasons against the scale of German reparations after World War I (in addition to being worried about the likely resentment they

would cause in the future). In such circumstances, deficit countries were bound to seek alternative remedies to deflation (for example, through protection) and this is exactly what happened. The liberal trading arrangements of pre-World War I gradually gave way to protection in the inter-war period and a system of currency blocks.

His early books in this period, *The Economic Consequences of the Peace* (1919) and the *Tract on Monetary Reform* (1923), and a famous pamphlet, 'The Economic Consequences of Mr Churchill' (1925), set out some of these forebodings and Keynes's clear preference for a system that gave priority to internal price stability rather than the external value of the currency. The case for internal price stability was succinctly put in the *Tract*:

Inflation is unjust and Deflation is inexpedient. Of the two perhaps deflation is, if we rule out exaggerated inflation such as that of Germany, the worse; because it is worse, in an impoverished world, to provoke unemployment than to disappoint the rentier. But it is not necessary that we should weigh one evil against the other. It is easier to agree that both are evils to be shunned.

(Keynes, 1971–88: vol. 4, p. 36)

The case against relying on the Gold Standard to achieve this stability was equally straightforward:

Confidence in the future stability of the value of gold depends therefore on the US being foolish enough to go on accepting gold which it does not want, and wise enough, having accepted it, to maintain it at a fixed value. This double event might be realised through the collaboration of a public understanding nothing with a Federal Reserve Board understanding everything. But the position is precarious ...

(ibid.: vol. 4, p. 135)

This is Keynes writing in favour of a system of managed currency with an elegance that was his hallmark. The real opportunity, however, to influence the shape of the international financial system came when World War II gave the

Allied powers the chance to design the system afresh. Keynes by this time held an unrivalled position of influence as the adviser to the Chancellor of the Exchequer and his thoughts began to take early shape in 1940. At first his inclination was to build on a sterling area which would be free to discriminate against the US if it persisted as a creditor country. However, the US opposition to any discriminatory system encouraged him to develop a more radical proposal that would combine a liberal trading system with non-deflationary international financial institutions. The result was his proposal for a Clearing Union that would not allow surplus countries to hoard reserves: they would be denominated in a new international money called bancors and become available to deficit countries through an international clearing bank. The Clearing Union would have, in effect, the capacity to evolve into a Central Bank for the world economy and it could use its credit-creating capacity to undertake counter-cyclical measures, make international investments and fund primary commodity buffer stocks.

The US counter-proposal from Harry White was more modest. It eschewed a new international money: gold was to retain a reserve role, along with the US dollar and sterling. But there was to be a stabilization fund to help the adjustment of deficit countries (albeit smaller in size than the facilities that would have been available under the Clearing Union). It was to be set up through the individual gold and currency subscriptions of member countries and deficit countries could conditionally draw on it in tranches. In addition, there was to be a bank with capital supplied by subscription that could make international investments. The US view prevailed, and the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK (INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT) were established at Bretton Woods in July 1944. Nevertheless, this represented an advance over the Gold Standard as far as Keynes was concerned, because the ability to draw on the stabilization fund would afford deficit countries some respite from deflation, as would the scope for devalua-

tion (which was now to be formally allowed within the system).

In fact, Britain had no choice but to accept the US view and the only real concession extracted from the US in negotiations was a 'scarce currency' clause that allowed deficit countries to discriminate against the goods of a surplus country whose currency had become scarce. The reality of the post-war world was such that the new international financial system was destined to be a dollar – not a *bancor* – standard and it would be run by the US and not some proto-international agency for the simple reason that everyone needed dollars; if the US was going to bankroll the world economy in the post-war period then it wanted to have control over the new institutions of the world economy. Put in this way, it may seem that the claim that Keynes was the key architect of this system is rather weak. But this is to ignore the contribution that Keynes had made to the change in the intellectual climate through his writings during the inter-war period. White was an admirer of Keynes and accepted that there could be no return to an international financial system that ran on automatic pilot. The world financial system had to be managed in the future so that a liberal trading order would not be undermined. It was Keynes more than anyone who caused this shift in opinion and White's view merely prevailed in the details of how the system was to be managed for this purpose. These details appeared at the time to play transparently to US interest and suspicion of international institutions. But the paradox is that, in hindsight, the US might well have fared better under the Keynes Plan, as Marshall Aid would have been treated as a credit at the Clearing Union, which the US could have drawn on much later when it turned into a deficit economy. As it was, Marshall Aid was a gift and long forgotten by the time the US became a debtor nation.

The General Theory

The General Theory (GT) was published in 1936 and it revolutionized economics. It

supplied a new theoretical analysis of persistently high unemployment and it offered policy advice on how to combat the problem. Timing, of course, is everything and in the 1930s unemployment seemed increasingly to be polarizing the world politically into Fascism or Bolshevism. In these circumstances, the GT's offer of a middle-way to manage capitalism for the better, while preserving the traditional liberal political freedoms was a heady mix; it was seized on by a new generation of economists in the US and the UK. Even so, it is doubtful that the GT would have had such an impact had it not been for the advent of World War II and the development of national income accounting. The latter enabled quantification of the analytic categories of the GT and the former placed economic advisers in key positions in government where they could use Keynesian ideas in the economic management of the war effort, and then, later, advise the new governments of Europe (notably in France and Italy). The result was the spread of the ideas of demand-management through monetary and fiscal policy manipulation, and the acceptance of government responsibility for maintenance of full employment.

The key theoretical argument of the GT concerns the absence of an automatic mechanism that will guarantee the attainment of full employment, at least over any interesting time period. The prospects of what might happen in the long run were of no interest to Keynes: as he had already famously remarked in the *Tract*, 'in the long run we are all dead'. The problem (in the short run) arises initially because the equilibration of aggregate demand and output (or savings and investment) is achieved through movements in output and *not* interest rates as the Classics supposed (see KEYNESIAN ECONOMICS). Thus, for example, a negative demand shock will cause output to contract (and with it employment). This initial contraction is then exacerbated by the multiplier process of adjustment, which takes hold in these conditions, whereby the initial contraction in output and income causes further reductions in demand, which produce yet further falls in output and so on. However, governments can

avoid the extreme movements in output by managing demand through compensatory monetary and fiscal policy changes, which smooth demand in the presence of such shocks (see MACRO-ECONOMIC POLICY).

Why do demand shocks cause output and employment movements according to this account? To illustrate the argument, consider a fall in investment demand that occurs, say, because businesses perceive greater uncertainty in the future with respect to their markets. The first part of the argument explains why the fall in investment demand leads to a fall in the aggregate demand for goods and services. This would not happen in the Classical world, because interest rates move downwards when investment demand contracts and this insulates aggregate demand from the shock to investment by priming consumption demand. Accordingly, the key to Keynes's argument at this point is a distinctively different theory of interest rates. In fact, his liquidity-preference theory of interest rates was a legacy of his earlier major theoretical work, the *Treatise on Money* (which had a mixed reception when published in 1930). To see how this theory differs from the Classical one, suppose there are only two financial assets: money (which is liquid but earns no interest) and bonds (which are less liquid but earn interest). For Keynes, the interest rate on bonds moves to ensure that people are content to hold the stock of bonds in their portfolios of wealth. So, to bring out the possible conflict with the Classical model in this instance, suppose that – as a result of the perception of greater uncertainty in the future – businesses not only invest less, but people's desire for liquidity also increases. On Keynes's view, the increased desire for liquidity would, all things being equal, cause interest rates to rise. The point is that the illiquid nature of bonds is now perceived more negatively and so, to ensure that people continue to hold the stock of bonds in their portfolios of wealth, the interest rate on bonds must rise. In comparison, in the Classical view, firms issue new bonds to fund investment decisions, people demand new bonds when they save and the interest rate moves to equate these new

demands and supplies. So when investment falls, so do interest rates: saving falls and consumption is primed. Thus the Classics focus on the flow-equilibrium for new bonds, while Keynes attends to the stock equilibrium for all bonds. Of course, the two equilibria are connected, as the flow additions of new bonds affect the overall stocks, but (given the large size of the existing stock of bonds in relation to new issues) there seems good reason for focusing on the stock equilibrium aspect since small changes with respect to the stock of wealth can dominate the influence of any change in the flow supply and/or demand for new bonds. Thus, Keynes concludes, there is no guarantee that a fall in investment will produce a fall in interest rates to prime consumption demand adequately in these circumstances; indeed, interest rates may not fall at all in the first instance.

Furthermore, when aggregate demand falls as a result of the decline in investment demand, output (and employment) fall because quantities adjust faster than prices to this demand shock. This is largely treated as a matter of fact in the GT and this is why, for much of the analysis, prices are taken as constant. But it is also because Keynes does not believe that price adjustments can be relied upon to close the gap between demand and supply in these circumstances. For example, in the case of the negative demand shock, there is the possibility that falling prices will create expectations of further declines and so people will delay their consumption (that is, it will fall further rather than increase to close the gap between demand and supply) and there is the possibility that falling prices will cause bankruptcies, so further lowering income and consumption.

The GT in many respects represents a significant departure from his two earlier books on monetary economics, the *Tract* and the *Treatise*. In those books, the concern was with price stability and with the difficulties of achieving this through monetary policy under the Gold Standard, when interest rates would often have to be set for external reasons. The theory belonged to a tradition that focused on the connection between money, prices and

interest rates, and it only considered output and employment (and specifically changes in them) as part of the analysis of price adjustment. In comparison, the GT focuses firmly on output and employment determination, for the most part under the assumption of constant prices and in the absence of external constraint. The reasons for the change are in part conjunctural. Once Britain had left the Gold Standard in 1931, one of the key concerns of his earlier work was removed because monetary policy was no longer constrained by external considerations. In part, the change was a direct response to some of the criticisms of his earlier work, notably that he had provided an account of output changes and not output determination.

Keynes's response to his critics was masterly and, although the emphasis is very different in the GT, there are important points of continuity with his earlier work. Unemployment was the central concern of those earlier works, it had merely been refracted through an analysis of how best to achieve price stability. Likewise, the proposal to use government spending to lower unemployment had been a crucial aspect of his policy advice, both in his popular writing and in his work for the Macmillan Committee. The GT, in effect, provides the rigorous theoretical framework to support this recommendation – indeed, fiscal policy does appear in the GT as the favoured policy weapon. Finally, there is a deeper continuity with his much earlier work, *A Treatise on Probability* (1921), which although published in 1921 began as a dissertation-submission for a fellowship at King's College in 1908. This work argued for an interpretation of probability as a form of logical insight regarding the relation between the evidence and the conclusion of an argument in opposition to the dominant frequentist view, and it yielded a distinctive theory of rational action under uncertainty. In particular, Keynes's theory allowed for rational action when the possible outcomes could not be represented by a numerical probability distribution: rational action was still possible in these conditions of uncertainty and depended

on a pragmatic knowledge of conventions and institutions. These ideas, particularly the part played by convention, contribute to the distinctive theorizing found in the GT, especially in relation to the analysis of investment decisions and the behaviour of financial markets.

There has been much controversy over what is the most important feature of the GT and its relation to the previous Classical economic theory. The legacy is disputed in all manner of ways. For instance, who should inherit the mantle? Is it the post-Keynesians, the neo-Keynesians or the New Keynesians? Likewise, there are disputes over whether the legacy is worth inheriting. Did it damagingly overlook inflation and the supply side of the economy, as some critics have maintained, or has it been so thoroughly internalized that most governments are Keynesian without really realizing it (see KEYNESIAN ECONOMICS)?

Mix Whitehall with Cambridge, then add a dash of Bloomsbury and the City

Keynes's Whitehall career began during World War I, when he worked in the Treasury, later becoming an official at the Versailles Peace Treaty negotiations. It was his presence at these negotiations that enabled him to write *The Economic Consequences of the Peace*. This was a bestseller that denounced the terms of the peace and established his reputation for commentary on the political and economic issues of the day. He maintained a steady stream of journalistic works after this time and some pieces are collected in the marvellously accessible *Essays in Persuasion* (1931).

The decision to work at the Treasury and so aid the war effort came as a surprise to, and was a source of criticism from, his Bloomsbury friends. Keynes, like many, had come under the influence G.E. Moore's *Principia Ethica* during his undergraduate days at Cambridge and had become, through 'the apostles' (then a secret philosophical society at Cambridge), a part of the Bloomsbury group. It was from this set of connections that Keynes got a vision of a heaven that comprised the pursuit of truth,

beauty and friendship. There was no place for war in this vision and certainly no place for participation. Bloomsbury had rejected the Victorian order and stood firmly in opposition to its war. So what was Keynes doing working for the Treasury?

Keynes always retained a certain worldliness which perhaps other members of the Bloomsbury group did not share. This vision of 'heaven' was to be pursued on earth. So the pursuit of truth, beauty and friendship required a secure economic underpinning, and this meant that compromises had to be made. Indeed, as Keynes suggests in 'The economic possibilities of our grand children',

For at least another one hundred years we must pretend to ourselves and to everyone that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our goals for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.

(Keynes, 1971–88: vol. 9, p. 372)

Personally, the recognition that 'heaven' had economic underpinnings meant that he needed to build his own wealth. More generally for society, it meant good government was required so as to manage the economy in the direction of plenty for all. The Versailles Treaty was bad government. Keynes denounced it as such (and this helped his reconciliation with Bloomsbury after World War I, because it set him firmly against 'the establishment'). The general source of good government was the advance of ideas. It was ideas that guided governments and so he set about developing and popularizing the ideas that would bring forward the day when we would be able to 'rid ourselves of many of the pseudo-moral principles which have hag-ridden us for two hundred years' (ibid.: 369).

On the personal side, Keynes famously made (and lost and remade) fortunes through speculation in commodity and currency markets. Add to all this activity his editorial duties, his membership of company boards and his guidance of the finances of King's College, and it may be tempting to think of Keynes as a

workaholic. But this misses the mark. Undoubtedly he did bustle about, however he also had a quality which all recognized as setting him apart. For some it came across as arrogance, to others it was sheer brilliance. It upset many (notably several American officials and politicians), but it was also awe-inspiring. Furthermore, he made time to explore bits of his 'heaven on earth'. He had a wonderfully happy marriage and his wealth enabled him to pursue beauty and friendship in comfort: he bought works of art, assembled a collection of rare books, bought property where it could be enjoyed and where friends could be entertained.

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SHAUN P. HARGREAVES HEAP

Keynesian economics

The inheritance left by JOHN MAYNARD KEYNES in economics has been variously claimed and interpreted (for example, by the post-Keynesians, neo-Keynesians and New Keynesians), but they share a view that the economy is liable to suffer from periods of significant unemployment unless the government manages final demand judiciously through fiscal and monetary policy manipulations. The contrast is with the Classics and their descendants (MONETARISM and the New Classical Economics) in whose view unemployment arises because real wages are too high. On this account, unemployment policy should be directed at encouraging wage flexibility and a constant monetary rule should be followed to provide for stable prices. This dispute has helped define macro-economics since Keynes wrote *The General Theory of Employment, Interest and Money* in 1936. The Keynesian side seemed to have achieved a complete ascendance by the early 1970s, when even Republicans like President Nixon declared that 'we are all Keynesians', only for the oil crises of the mid- and late-1970s and the subsequent deterioration in economic performance to herald what was widely taken by the 1980s to be the death of Keynesianism. In fact, Keynesian economics never died. Indeed, it has enjoyed both a theoretical and a practical revival in recent times, perhaps in part because unemployment is again regarded as a major macro-economic problem.

The dispute between the Keynesian and Classical views essentially concerns whether demand shocks in goods markets get transmitted to the labour market to cause unem-

ployment. The source of demand shocks can be various, but there was one key source for Keynes: the presence of uncertainty. Some aspects of the future cannot be sensibly predicted, even in a probabilistic sense, and as a result expectations are not always anchored in rational calculation. Instead, they can vary as sentiment takes on a more or less optimistic/pessimistic temper. Consider, for instance, a pessimistic turn in expectations that leads to a fall in business-investment demand for new plant equipment because the expected future returns on these investments are revised downwards. In such circumstances, demand overall will fall unless there is some compensating increase elsewhere.

The Classics thought that interest rates would fall in these circumstances and thus provide compensation by priming consumption demand. But Keynes argued that this was extremely unlikely, as the pessimistic turn in expectations would also lead people to want to hold more liquid assets like money in their portfolios, and this would tend to put upward rather than downward pressure on interest rates. Accordingly, overall demand for goods would fall and, unless prices adjust instantaneously to compensate, the output of goods will decline and with it the demand for labour to produce these goods. In turn, unless wages adjust instantaneously to compensate for a fall in the demand for labour, employment falls and unemployment rises. As a matter of fact, prices and wages do not adjust instantaneously in most markets and, in any case, Keynes also doubted whether wage- and price-changes would actually help (at least in the short run) in these circumstances. The inference drawn by Keynes, then, was that a judicious manipulation of monetary and fiscal policy was required to boost aggregate demand and so compensate for the fall in investment demand and avoid the rise in unemployment (see MACRO-ECONOMIC POLICY).

This revolution in economic thinking spread quickly during the post-war period and it is often credited with contributing to the exceptional period of high and stable economic growth in the 1950s and 1960s (what is

sometimes referred to as the 'Golden Age'). However, it is difficult to find clear evidence that points to monetary and fiscal policy changes having a significant stabilizing effect in this period. In part, this is unsurprising because monetary and fiscal policy changes were sometimes quite explicitly undertaken for other reasons (for instance to combat a current account deficit in the balance of payments or an accelerating rate of inflation). Nevertheless, it is possible to argue that the real influence of the revolution came through its indirect effect on the character of people's expectations. In particular, people may have believed that Keynes had given governments the weapon to deal with mass unemployment and this may, in turn, have made expectations more robust than in the inter-war period. Thus, when expectations turned pessimistic and output began to contract, expectations in the post-war period were less likely to become even more pessimistic through extrapolation from the current downturn (and so add to that downturn) than had been the case in the inter-war years. On this view, the discrediting of Keynesianism in the 1970s and 1980s may have contributed to the greater economic instability of those decades by undermining the source of the earlier robustness in expectations.

It is sometimes argued that the scope for Keynesian demand-management has been circumscribed by the GLOBALIZATION of most major economies. There is little doubt that the scope for independent demand-management policies has been reduced and that this has sometimes encouraged governments to pursue coordinated fiscal and monetary changes through institutions like the GROUP OF 7 (G-7). It is always difficult to judge whether such attempts at coordination have been successful because it is never clear what governments would have done in the absence of such coordination. Nevertheless, there is one clear example where coordination did take place (this time between Central Banks) in a manner that would have met with Keynes's approval. This was in 1987, when stock markets crashed quite spectacularly. The Central Banks of the major economies moved quickly to pump

liquidity into their respective banking systems and this undoubtedly averted the kind of knock-on effects which had been experienced after the 1929 Great Crash. Even the critics of Keynesianism do not doubt this effect (rather, their complaint is usually that Central Banks were rather excessive in this respect and their actions contributed to overheating in the world economy and a rise in inflation).

See also:

inflation; investment; monetary policies; multiplier principle; post-Keynesian economics; unemployment

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SHAUN P. HARGREAVES HEAP

Keynesianism, military

The first practising 'military Keynesians' were either Adolf Hitler or the successors of Korekiyo Takahashi, Japan's Finance Minister in the 1930s. It is important to recognize that it is the use of increases in military spending to

'grow the economy', plus easy monetary and/or fiscal policies that differentiate military Keynesians from other 'bastard Keynesians'.

Hitler was initially not a military spender of great note. Rather he engaged in other public works, such as the great system of *autobahns*, at the same time as he rejected conventional monetarist advice (see MONETARISM). Rather than getting workers to take a 10 per cent wage cut (as under Brüning) or devaluing the currency (as in Great Britain or the United States), Hitler engaged in deficit financing and a policy designed to reduce interest as a percentage of total income. It was only after this pragmatic Keynesian policy had produced full employment in 1936, that Hitler began to increase military spending significantly. It was this decision that resulted in the resignation of Hjalmar Schacht, his early economic adviser, a move that eventually spared Schacht's life after the Nuremberg trials.

In the case of Japan's Takahashi, the Japanese military were forced to assassinate the eighty-one-year-old financial leader in 1936 before engaging in an early version of military Keynesianism.

President Roosevelt became a military Keynesian as a result of World War II. In addition to the large increases in military spending, Roosevelt froze nominal interest rates at approximately 2 per cent in early 1942, where they remained until after the Treasury Accord in March 1951. Since there was considerable wartime INFLATION, particularly after a Republican Congress scuttled wage and price controls in 1946, the real interest rate was significantly negative over this decade.

The United States bore the brunt of military spending during the COLD WAR and has been the chief practitioner of military Keynesian policies. Leon Keyserling (President Truman's chief economic adviser in 1950), along with Paul Nitze, helped produce NSC-68, which outlined the plan to use military spending to defeat the Russians in the Cold War. President Kennedy revived military Keynesianism after eight years of non-Keynesian policies under Eisenhower. After Kennedy's confrontation with Krushchev in early 1961, US military

spending became a leading sector responsible for a growth under the 'New Economics'.

The last military Keynesian president was Ronald Reagan. Inheriting a large increase in military spending planned by Jimmy Carter, Reagan carried out his campaign promises of three successive cuts in income tax. Since then, emphasis on balancing the budget has all but totally eliminated any Keynesian influence on US economic policy.

See also:

Keynesian economics

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LYNN TURGEON

Kindleberger, Charles

Charles Kindleberger is one of the founding fathers of the field of international political economy (IPE). He has published on an uncommonly broad range of topics, including DEVELOPMENT, trade, MULTINATIONAL CORPORATIONS (MNCs), MONEY, finance and economic history. The breadth of his contribution defies simple summary, but his influence is clearly felt on the style, substance and method of the discipline. The style is unmistakably interdisciplinary, an approach to political economy that is pluralist rather than imperialist, and which includes a combination of economic and political questions, theories and analyses. Substantively, across the range of Kindleberger's

contributions to IPE, his emphasis on the importance of international leadership stands out. As for method, Kindleberger is the champion of the use of economic history, or, in his terms, of historical economics.

Kindleberger received his doctorate in economics from Columbia University in 1937. From this early date, some of the themes that would dominate his future work are present, as seen in his paper on the self-defeating consequences of competitive currency devaluation (1934) and his dissertation and subsequent book on capital movements (1937). After graduate school, Kindleberger worked in the Federal Reserve System and subsequently served in the Office of Strategic Services and the 12th Army Group during World War II. This was followed by three years in the State Department, which he left in 1948 to join the economics department at MIT. The following half-century witnessed a productive and prolific academic career, punctuated by numerous honours and achievements, including the Presidency of the American Economic Association in 1985 (see 1991 for details).

One of the great strengths of Kindleberger's analysis is that he recognized, from the beginning, that politics and economics were not easily separated. In particular, he emphasized the ways in which international economic interactions necessarily led to domestic political problems that required international political solutions. Indeed, Kindleberger is a true *political* economist, dating from a time when this was much less common than it is today. Kindleberger served on the editorial boards of both *International Organization* and *World Politics*, and consistently explored the links between politics and economics, as seen most visibly in his book *Power and Money* (1970). Politics enters the picture at both the domestic and the international level. Within societies, economic policies are recognized as benefiting some groups and hurting others, and not understood solely in terms of aggregate efficiency.

Kindleberger's sensitivity to international politics has been particularly inspirational to students of IPE. His paper, 'The international

monetary politics of a near great power', for example, which stressed the 'high content of pure politics' to be found in international monetary relations (1972: 119), had a profound influence on scholars of international relations (IR) exploring the links between political economy and national security. This paper also advanced the hypothesis that middle powers are a likely source of difficulty in the international system. The self-interests of great powers, he argued, are likely to be compatible with systemic stability, while small states are relatively inconsequential. Middle powers, on the other hand, do not have the capacity to stabilize the system, but possess the power to disrupt it, and may pursue national goals that diverge from the interests of the system as a whole. It should be noted that Kindleberger does not err in the opposite direction and oversell political variables, as is seen in his nuanced assessment of the relationship between trade and war (1962), an issue area that has often attracted exaggerated claims and counter-claims.

Kindleberger's most visible contribution to IPE has been his support of the position that stability in the international system requires one state to take a leadership role. This argument was most clearly expressed in his seminal book, *The World in Depression* (1986 [1973]) and again in *World Economic Primacy* (1996). In *World in Depression*, Kindleberger concluded that the GREAT DEPRESSION was longer, wider and deeper than it might have been, due to the absence of international leadership. The lessons are general: leaders can inhibit beggar-thy-neighbour trading policies, contain financial crises and ensure monetary stability (see BEGGAR-THY-NEIGHBOUR POLICY). While this argument sparked a vast and often critical literature, challenges to his position have been more successful regarding trade than they have been with respect to money and finance, where public goods problems remain robust.

In the macro-economic sphere, for example, Kindleberger notes the tendency for new liquidity to be withdrawn in a financial crisis, the result of a classic COLLECTIVE ACTION

problem where every actor pursuing their own narrow interest serves to exacerbate the overall financial crisis. Within states, the common solution is to have a lender-of-last-resort, but in the international system, given the absence of international government, there is no standard mechanism for containing financial crises. Only with a leader that can see sufficient overlap between their interests and the interests of the system as a whole is this problem likely to be mitigated. A similar problem plagues international monetary relations. Without a leader to oversee the system, individually rational devaluation can deteriorate into collectively disastrous currency competition, as states are trapped in PRISONERS' DILEMMAS, just like Denmark and New Zealand were in the inter-war period.

It is interesting to note that these views do not fit comfortably into either the liberal or the realist approach (see REALISM). Kindleberger is no realist, speaking the language of PUBLIC GOODS and prestige, rather than dominance and relative gains. Yet at the same time, the argument is very statist. Kindleberger has remained sceptical that non-state institutions or regimes can substitute for the leading state, questioning in particular the ability of institutions to react to destabilizing shocks given the complications of international politics.

Those destabilizing shocks more often than not originate from monetary and financial sources. Such markets, Kindleberger explained in *Manias, Panics and Crashes* 'generally work but occasionally break down' (1989a [1978]: 7). Persistent disequilibrium in balances of payments and destabilizing speculation are not uncommon phenomena. Leadership is not only needed to contain financial crises, but is also crucial in the monetary sphere, for a distinct reason. International money. Kindleberger has argued, is inherently hierarchical. Given ECONOMIES OF SCALE and efficiency, the world will tend to converge around one international money, just as it does one international language (see 1967). This creates a need for the state that issues the international currency to be more than self-regarding, since its monetary policy has profound global ramifications.

If that state fails to assume its leadership responsibilities, its policies cause additional instability in the international economy.

Kindleberger's choice of method also stands as an important contribution to IPE. Over the course of his career, he turned increasingly to economic history, a turn most visible with the publication of *Economic Growth in France and Britain* (1964). Kindleberger came to define himself as an 'historical economist', referring to *A Financial History of Western Europe* (1993 [1984]) as 'perhaps my *chef d'oeuvre*' (1991: 204). Historical economics is 'interested in how general are economic theorems or laws, how well they fit case 2 if it is evident that they fit case 1 neatly' (1991: 193). This style of analysis is visible in two papers that had a profound influence in IPE: 'Group behavior in international trade' (1951) and 'The rise of free trade in Western Europe' (1975). The former served as a point of departure for the burgeoning literature in comparative political economy that emerged in the mid-1970s, while the latter paper (a staple on IPE reading lists) was an important precursor to more recent literature that emphasizes the importance of ideas and ideology in explaining foreign economic policy.

Historical economics is interdisciplinary, theory-driven and primarily qualitative. The historical economist avoids the 'jurisdictional fallacy' of explaining 'everything in economic terms' (1978: 5). Further, within the economic realm, theories – not methods – are paramount. 'Economics is a toolbox' (1990: 9) and 'there is not one all-purpose economic theory or model that illuminates economic history' (1989b: ix). In *Economic Laws and Economic History* (1989b), Kindleberger demonstrates how to use those tools – GRESHAM'S LAW, the Law of One Price and others – and argues that they are just a few of the hundred or so that economists have at their disposal.

Kindleberger continues to practice what he preaches (1998). His contributions to the style, substance and method of IPE remain one of the richest and most formative influences on the discipline.

See also:

hegemonic stability; hegemonic stability theory

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JONATHAN KIRSHNER

Knorr, Klaus E(u)gen (1911–90)

Klaus Knorr received an LLB from the University of Tübingen in 1935 and a Ph.D. in economics from the University of Chicago in 1941. He served as a Research Associate at Stanford University during World War II, after which he became a research associate in the Institute of International Relations at Yale University. When Yale's institute was abolished by the university's president in 1951, he moved with five of his colleagues to Princeton University to found the Center of International Studies. He remained at Princeton until his retirement in 1979. From 1953 to 1979, he served as editor of *World Politics*.

Knorr's work was interdisciplinary in the sense that it combined economics, history, political science and international relations. Almost all of his work fell under the broad rubric of international political economy. Even his work on national security and military strategy brought to bear the analytical perspectives of economics. He was one of the few scholars with sustained interest in international political economy during the first two decades after World War II, when international relations was dominated by a concern with military affairs.

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DAVID A. BALDWIN

knowledge industries

The knowledge industries are conventionally seen as those in which value added stems primarily from the utilization of knowledge in one form or another. In these industries the most important input is non-material, though not necessarily to the exclusion of material inputs or components altogether. This encompasses the media and publishing, the communication industries and information services, all of which depend for their profitable existence on the manipulation of knowledge and its delivery to end-users. But it also includes such knowledge intensive industries as biotechnology, design and financial services. The key TECHNOLOGY that has enabled the expanding and accelerated use of knowledge in the international political economy is cheap, yet

powerful computing. The ability to control, direct and profit from flows of vast amounts of information and knowledge-based resources sets these industries aside from those that depend primarily on the transfer of some sort of material product.

The shift to knowledge as a highly valued definable input has produced a vast literature proclaiming POST-FORDISM or POST-INDUSTRIALISM, a new post-capitalist knowledge and information economy (see INFORMATION SOCIETY/ECONOMY), spearheading a new economic revolution. Tending towards a rather crude technological determinism, such claims tend to be pessimistic about the impact of the knowledge industries. Writers such as Robert Reich argue that while 'symbolic analysts' will benefit from such changes, large groups of manual workers will be impoverished by the increasing importance of knowledge industry. The decline of manually skilled jobs and the rising centrality of knowledge will produce a division between the information or knowledge rich and poor. But, despite their popularity, analyses of the expansion of the knowledge industries raise two significant problems: the difficulties of establishing a robust definition of and a periodization for this apparently new phenomenon.

If knowledge is defined narrowly to encompass only codifiable information and facts such as patented processes or the transfer and sale of copyrighted information resources, then the knowledge industries can be distinguished from other sectors. In this model, the knowledge industries are concerned with the discovery of new technical knowledge and the manipulation of collected information. The ability of computers to compile, calculate and manipulate streams of information very quickly has enabled new uses to be put to all sorts of collectable information. It is the speed of deployment of information, however, that has changed more often than its potential content. These information- or knowledge-provider services are a powerful resource for many industries, but are often dependent on the material world of the old industrial economy to realize their gains. They are producer services

rather than profitable industrial sectors with no link to the material (as some post-industrial commentators suggest). But to limit the definition in such a way excludes many sectors that might usefully be included in discussion of the economic and industrial importance of knowledge.

If knowledge is defined widely to encompass such issues as branding, design, continual innovation and the heightened use of employees' own knowledge in one form or another, then it starts to capture the widening importance of knowledge utilization in the international political economy. But equally, such a definition of the knowledge industries approaches that of modern CAPITALISM itself. These issues are not new, though the pace and intensity of their adoption and exploitation may have increased. If knowledge is understood in this way – to be the aspect of the value added of any product or service that is not strictly materially based – then all capitalism since the industrial revolution has been made up of a constellation of knowledge industries (differing only in levels of knowledge utilized). And, despite the potential for knowledge to be emancipatory, the LABOUR RELATIONS of the knowledge industries resemble previous ways of organizing capital and labour, rather than differing from them in any substantial way.

In management theories over the last twenty years, this issue of knowledge as an increasingly valuable resource has become widely recognized. This is in addition to the growing recognition that the tacit knowledge of workers and managers is often one of the company's most valuable (yet difficult to quantify) assets. Strategies for both capture and control of knowledge are key elements for many actors (from companies to individuals, states to NON-GOVERNMENTAL ORGANIZATIONS (NGOs)). It is frequently proposed that knowledge has become the only 'core competence' that matters for the retention of competitive advantage in the international political economy. As knowledge has become an increasing element in the value added relative to the material properties (and physical labour inputs) of COMMODITIES, so capitalists need to capture such knowledge

for their exclusive use. Though knowledge has always fed into productive processes and services, it is now increasingly subject to property regimes.

INTELLECTUAL PROPERTY RIGHTS (IPRs) have commodified the inputs on which knowledge industries have relied and in doing so have recognized a new sort of productive activity – the use of knowledge resources to create innovative and profitable further knowledge resources. But this has also revealed an interesting paradox – by the commodification of their own inputs, the knowledge industries have relocated some knowledge from the freely available public realm to the priced (and scarce) private realm. This has led to tensions between different knowledge-dependent companies and sectors. Recent disputes have ranged from the patenting of seed varieties from India and personal genetic patterns by American chemical multinationals, to disputes over the copyright position of TV programme listings reproduced (and sold) without the specific permission of broadcasters. Unsurprisingly, the internet has also proved to be a fertile area for disputes over the ownership of knowledge resources accessed remotely and then reproduced. All this suggests that the enclosure of the public realm of knowledge and the defence of intellectual property in its varying forms may be an interesting site of contest in the future.

Defining the knowledge industries by form, recognizing their new methods for utilizing a widely defined area of knowledge – through branding, design, research, the utilization of database resources, communications and so on – a new period of capitalism might be posited. But, recognizing the relations between the holders of knowledge and the companies and other actors who profit from it, as well as the way such knowledge is deployed and appropriated through IPRs, the substance of the knowledge industries remains part of modern capitalist development. While they may be new, the knowledge industries are not novel.

See also:

knowledge structure

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CHRISTOPHER MAY

knowledge structure

The knowledge structure was introduced by SUSAN STRANGE into her work to capture the power which derives from the control of knowledge. Though STRUCTURAL POWER itself is reliant on the mobilization of knowledge, for Strange all four structures (security, production, finance and knowledge) impact on each other with no single one being of automatic analytical priority. The knowledge structure is therefore penetrated by the structural power derived from material resources in the other structures and does not represent something

above (or prior to) the material world of political economic relations.

Strange suggests three central changes possible within the knowledge structure itself: changes in the provision and control of information or communication systems; changes in the use of language and non-verbal channels of communication, and changes in belief systems which influence value-judgements, and thus political and economic decisions. The knowledge structure is intended to encompass a field stretching from the control of data-resources (including issues of TECHNOLOGY TRANSFER) through to the power of IDEOLOGY and its impact on political economic relations.

Thus authority in this structure may be based on socialized belief systems or status conferred by the possession of valued knowledge, giving power over access and communication of knowledge resources. As knowledge becomes increasingly recognized as a valuable economic resource, its role becomes a crucial aspect of any analysis seeking to understand and explain power in the INTERNATIONAL POLITICAL ECONOMY (IPE). The knowledge structure highlights power issues around the information rich and poor, the GLOBALIZATION of certain belief systems and the rise of the global KNOWLEDGE INDUSTRIES.

See also:

epistemic communities; financial structure; information society/economy; neo-Gramscianism; production structure

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Kondratieff waves

Strange, S. (1988) *States and Markets*, London: Pinter. The knowledge structure situated within Strange's overall perspective.

CHRISTOPHER MAY

Kondratieff waves

Kondratieff waves (or, for short, K-waves) may be defined as a pattern of regularity characteristic of structural change in the modern world economy. Some sixty years in length, the pattern consists of an alternation of periods of high sectoral growth with start-up periods of slower growth. The study of this pattern helps to trace the evolution of the global economy, and aids in politico-economic prediction.

The concept

Since the onset of the twentieth century, students of the world economy have been drawing attention to certain long-term regularities in the behaviour of the leading economies. The first to make this argument in a sustained manner was Nikolai Kondratieff (1984), a Russian economist writing in the 1920s. Statistical work on the behaviour of prices and some output series for the United States and Britain since the 1790s, led him to conclude that the existence of long waves was very probable. He saw the capitalist world economy as evolving and self-correcting and, by implication, he denied the notion of an approaching collapse of capitalism, then current among Marxist economists.

In the 1930s, JOSEPH SCHUMPETER endorsed this concept and named the pattern the Kondratieff, a name that has since been attached to this phenomenon, even when its existence remained in contention in the years after 1945. Neo-classical economists (see NEO-CLASSICAL ECONOMICS) have remained wary and it was only in the 1970s, as the post-World War II expansion slowed down once again, that attention was drawn to the phenomenon and

new research (especially on innovation) moved the subject forward in an important manner.

Characteristics

The emerging view – now broadly characteristic of a significant body of scholarship (see, in particular, Berry, 1991; Freeman, 1983; Modelski and Thompson, 1996; Rostow, 1978; Van Duijn, 1983) – might be summarized as follows:

- 1 K-waves are attributes of the world economy and are more visible in international production-data than in those of individual national economies. They are processes characteristic, first of all, of a lead national economy (such as that of the United States, or Britain in the eighteenth and nineteenth centuries) and, second, of the world trade in products and services of LEADING SECTORS, hence of the global economy.
- 2 K-waves concern output, rather than prices, and sectoral output surges and infrastructural investment in the world economy rather than the general macro-economic performance – for example, growth of GROSS NATIONAL PRODUCT (GNP) – of national economies. They should not be sought for in the ups and downs of such indicators as GROSS DOMESTIC PRODUCT (GDP) and must be distinguished from shorter-term BUSINESS CYCLES and fluctuations in the economic conditions of individual countries. However, high-growth periods for leading sectors tend to translate into general economic expansion and prosperity.
- 3 K-waves unfold as phased processes that imply S-shaped growth (or learning) curves, including – for each particular sector over a period of some fifty to sixty years – a period of slow start-up, followed by fast growth and ultimate levelling-off. That is why they are waves of economic activity, each wave different in kind from the last one, rather than cycles, which are seen as mechanical fluctuations in attainment of some uniform quantity. The start-up period of the next leading sector is also the period of flattening

growth-rates, declining profits and severe competition for the previous lead industry; this transition between two leading sectors' peaks may be known as 'downswing' and takes the form of generalized slowdown and, in the 1930s, of the GREAT DEPRESSION.

- 4 K-waves arise from the bunching of basic innovations that launch technological revolutions that in turn create leading industrial or commercial sectors. In Schumpeter's classic formulation, such innovations concern new products, services and methods of production, the opening of new markets and sources of raw materials, and the pioneering of new forms of business organization. In that sense, K-waves are caused by the demand for solutions to new problems and the supply of such solutions by innovative firms. Each such wave therefore has its own individual innovative character and can be named accordingly (consult Table 3 for such a listing).
- 5 K-waves have their own characteristic location in space and time. Britain's cotton wave was centred on Manchester. The information K-wave is preferentially seen in such locations as Silicon Valley in California. K-waves also have a clear location in time and can be dated. There is no standard listing, but there is some agreement on the four or five most recent ones. Historians and world-systems theorists now extend such dating further into the past (see WORLD-SYSTEMS THEORY). Table 3 offers one recent scheme, reaching all the way back to Sung China, which is grounded in the argument that the origins of the contemporary global economy might be traced to that source one millennium ago. The dates shown next to each K-wave are for the hypothesized start-ups, and the transition period that follows, with the high-growth peak reached only some thirty to sixty years later. All such dates must, of course, be regarded as approximate.
- 6 K-waves each have their own special character and specialization, but each in its own way also changes the structure of the world economy; that is why a sequence of K-waves gives rise to structural transformations.

Peter Hall and Pascal Preston (1988) have shown that the three most recent K-waves (those that launched, among other things, the telegraph and electric power, radio and electronics, and computers and the information industries) might jointly be seen as the carriers of the information revolution. Only in such an extended time-frame can truly long-term processes be properly observed.

Kondratieffs and war

Students of INTERNATIONAL POLITICAL ECONOMY (IPE) have had a long-standing interest in the relationship between K-waves and war. Indeed, Kondratieff himself might be regarded as the originator of the hypothesized link between these two phenomena. In particular, he argued that wars and revolutions (see WAR) were more likely to occur during what might be called a long start-up, or the transition period. A striking illustration was the Great Depression of the 1930s sandwiched between the World Wars and between two K-wave peaks, those of pre-1914 and post-1945 expansion.

In a thorough empirical study of that relationship in a long time-frame, Joshua Goldstein (1988) sees economic upswings associated with K-waves as increasing the probability of severe war. Brian Berry (1991) doubts such a connection and is troubled by the notion of an inherent tendency to wars in the global political system.

Kondratieffs and global leadership

Goldstein also recognizes but a loose connection between long economic waves and the fortunes of major powers in the modern world. An alternative view (Modelski and Thompson, 1996) argues for a much closer tie in the important structural relationship between K-waves and global leadership. For, if the series of K-waves shown in Table 3 can be seen as the rise and decline of successive globally significant lead industries, then the same table also shows that the series is tightly linked to a parallel (and structurally similar) process: the rise and decline

Kondratieff waves

Table 3 The co-evolution of global politics and economics

Long cycles	World powers	Date	K-waves	Global leading sectors
LC1	Northern Sung	930 990	K1 K2	Printing, paper National market
LC2	Southern Sung	1060 1120	K3 K4	Fiscal framework Maritime trade expansion
LC3	Genoa	1190 1250	K5 K6	Champagne Fairs Black Sea trade
LC4	Venice	1300 1350	K7 K8	Galley fleets Pepper
LC5	Portugal	1420 1492	K9 K10	Guinea gold Spices
LC6	Dutch Republic	1540 1580	K11 K12	Baltic trade Asian trade
LC7	Britain I	1640 1680	K13 K14	American plantations Amerasian trade
LC8	Britain II	1740 1792	K15 K16	Cotton, iron Railways
LC9	United States	1850 1914	K17 K18	Electric power, steel Electronics, motor vehicles
LC10		1973 2026	K19 K20	

Source: Based on Modelski and Thompson, 1996: 137, Table 8.5

of world powers and, hence, lasting change in world political arrangements. The latter process is often referred to as the HEGEMONIC CYCLE or as the long cycle of global politics (see EVOLUTIONARY WORLD POLITICS).

While the precise conditions of that process remain a matter of debate, the existence of a succession of world powers in modern world politics is now taken for granted and the similarities in the several approaches are now

greater than the differences. All of the participants in that debate, including ROBERT GILPIN, IMMANUEL WALLERSTEIN and Paul Kennedy, recognized the role of economic growth in that process (see discussion in Thompson 1988, chaps 2–3, 6–8). We can also show that the world powers that served as a focus of world politics accounted for the major proportion of economic innovations.

The left-hand column in Table 3 lists the powers that exercised global leadership (and contended with successive challenges from, among others, Spain, France and Germany) in the past 500 years; for the earlier era, it starts with Sung China and adds the two Italian republics, Genoa and Venice, that might be regarded as prototypical of later oceanic powers at a time when Mongols (and then Timur) held sway over Eurasia. The rise of each such power is seen to be coordinate with K-waves in two ways: in space (in as much as each K-wave is largely located in the world power of that period) and in time (in as much as the timing of these two processes of change is synchronized). What is more, a lead economy that succeeds in launching lead industrial sectors is a necessary condition in attaining global leadership; in turn, attainment of global leadership creates the political framework for a global economic order.

In that way, each long cycle of global politics has been matched, in the experiences of the modern world, by two Kondratieffs. The first of these serves to establish the necessary conditions for global leadership (as when, in the late-nineteenth century, industrial expansion in steel, chemistry and electric power laid the foundation for the United States' role in the twentieth century) and the second is put in place as the result of the attainment of that leadership (as when the settlement of 1945 paved the way for the economic expansion of the post-war years, led by cars, oil and electronics). The location of the (odd-numbered) K-wave therefore serves as leading indicator of next global leadership.

These considerations throw light on the question of the endogenous and/or exogenous nature of these processes. At one level, the K-wave might be seen as an endogenously generated response to system problems facing the world economy: basic innovations are seen as responses to system problems, thus railways are considered to have been meeting the demands of a rising industrial economy. At the next level, though, as just shown, K-waves in turn determine and are determined by

help determine the selection of global leadership and they are determined by the political framework that leadership has established. In that sense, K-waves are exposed not to random shocks (as some economists have called wars) but to predictable influences that make them coordinate with (evolutionary) global political change.

Evolutionary explanation

The prominent explanation of K-waves relies on the role of basic innovations leading to a succession of socio-technical paradigms. The drivers of that evolution are large and small firms, often fresh start-ups, that launch innovative products that are (or are not) selected by consumers/buyers in the marketplace and, when selected, are diffused until they reach saturation in their respective markets. The selective pressure is that of markets, but these markets might include large buyers (such as governments) whose demands and research can stimulate innovation. This economic process co-evolves with the political one of rise and decline of world powers. This is a Kondratieff-Schumpeter type of explanation of the change in the global economy and it might best be described as evolutionary.

Implications

The study of K-waves has predictive value because it helps to define the long-term development tendencies characteristic of the time and place. It is now quite widely agreed that the leading sectors of the late-1990s are the information industries (see also Hall and Preston, 1988) and that K-wave 19 is now about to move into a higher gear for a period likely to extend for some two to three decades. The United States seems to be on the leading edge in most segments of this large sector. If leadership in this, the nineteenth K-wave, is a leading indicator of future global leadership, then the United States is well positioned for it. Other countries prominent in the information industries, including Japan, are also well placed for future growth. Most generally, the lowering

Korean War

of the cost of information that results from this trend has a large positive impact on the worldwide spread of democracy.

See also:

hegemony; long cycles; Rostow, W(alt) W(hitman); Schumpeter, Joseph Alois

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GEORGE MODELSKI

Korean War

The Korean War (1950–3) was a civil war between the Western-leaning Republic of Korea (South Korea) and the communist Democratic People's Republic of Korea (North Korea) that led to the deaths of as many as 3,000,000 people and remains in a state of ceasefire rather than permanent peace. The war offered the first opportunity for the United States to counter COMMUNISM militarily and hence set the scene for the open confrontation that characterized the international order until the collapse of the Soviet system in 1989. The economic boom that the war stimulated in Japan was a powerful growth engine for the economy of that country as a whole.

The unified Korean peninsula had been ruthlessly colonized by Japan since 1910. The end of World War II saw the Japanese driven from Korea by Allied troops from the South and Soviet Russian troops from the North. The two sides met at the 38th Parallel. Communist sympathies were strong in both halves of the peninsula – partly in response to past oppression – but although they were encouraged in the North, they were suppressed in the South. Enmity between the two swiftly became sufficiently intense for warfare to erupt with incredible ferocity. Initial success by the North led to the evacuation of the capital Seoul and the withdrawal of forces to an area surrounding the southern port of Pusan. Exhibiting astonishing military flair, the US-led allied forces attacked Seoul's port of Inchon and with the impetus gained drove the opposing forces far to the north. However, over-ambitious plans to establish a new border along the Yalu river provoked the intervention of the People's Liberation Army (PLA) from China. The PLA was a huge body of people, often armed only with sticks or grenades and relying on horrifying human-wave tactics to demoralize and destroy opponents. In due course, the border was re-established along the 38th Parallel; this remains the status quo, rendering all the death and destruction of the war wasted.

In subsequent years, South Korea – pro-

tected by US forces and provided with preferential access to US markets (and also benefiting from the Vietnam War in the same way that Japan benefited from the Korean War) – has developed through government-led industrialization to become a developed nation and member of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD). Meanwhile, the North has stagnated under the leadership of first Kim Il-Sung and then his son Kim Jong-Il to become one of the poorest countries in the world, racked with poverty and famine, and with scarcely a viable economic enterprise in operation. Still, the two sides continue to glare at each other across the demilitarized zone (DMZ) – a reminder of COLD WAR politics. The heavily-mined DMZ is one of the principle reasons why the United States remains opposed to signing the treaty banning landmines. The propaganda and hatred both sides have disseminated about the other make it difficult to believe that peace and harmony will ever be restored, although in recent years some progress has been made in permitting South Korean companies to make business connections with the North – a process that appears essential if the DPRK, now no longer able to look to the support of its former comrades in Russia and China, is not to collapse into destitution – and limited contact among family members.

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JOHN WALSH

Kuwait Fund

The Kuwait Fund for Arab Economic Development (Kuwait Fund) was established in December 1961. The Fund's initial mandate was to provide financial and technical aid to Arab countries, which was later extended to include any developing country (see DEVELOPING COUNTRIES).

See also:

Arab Fund for Economic and Social Development (AFESD)

J. ANDREW GRANT

Kuznets U-hypothesis

The Kuznets U-hypothesis states that in the course of economic DEVELOPMENT, as measured by growth of real per capita GROSS NATIONAL PRODUCT (GNP), a nation's distribution of personal income will become at first more unequal, then stabilize and then become more equal, as a secular trend. Kuznets recognized differences between developing countries today and the early experience of already industrialized countries, and warned against applying lessons learned from the study of the latter to the former. Unfortunately, a number of economists have failed to heed this warning and have conducted cross-national studies in an attempt to establish empirical support for the generalization of the hypothesis to present-day developing nations. Those studying international political economy would do well to recall that a nation's development is not determined solely by internal factors in isolation, and that careful examination of the global context is crucial to considerations of both growth and income distribution.

MATHEW FORSTATER

L

labour aristocracy

The term 'labour aristocracy' denotes a distinctive upper stratum of the working class which has different interests from the rest of the class. It appears to have been introduced in the mid-nineteenth century to describe a particular British characteristic. MARX and Engels argued in the *Neue Rheinische Zeitung* (October 1850) that Chartism had split between a revolutionary fraction, representing the mass of workers living in truly proletarian conditions, and a reformist fraction, representing the labour aristocracy. For Engels, labour aristocracy reflected the spread of bourgeois ideas within the English working class (see CLASS, WORKING). LENIN also related labour aristocracy with reformism in the labour movement. For both Engels and Lenin, labour aristocracy is a phenomenon predating the emergence of monopoly capitalism. However, Lenin added that the possession of colonies can be beneficial to the 'labour aristocracy' of the advanced countries, since it might facilitate wage increases. Subsequent studies usually identified 'labour aristocracy' with skilled labour. In the 1970s, DEPENDENCY THEORY extended Lenin's second thesis and argued that the working class in the advanced capitalist countries can become a form of collective 'labour aristocracy' by benefiting from the exploitation of the workers of the undeveloped countries. Later studies – particularly the labour process debates of the 1970s and 1980s – elaborated more fully on the composition and stratification of the working class. Instead of a rather simplistic identification of 'labour aristocracy' with skilled labour, these approaches studied differentiations such as those between

manual/mental and skilled/unskilled labour as themes for different interests of segments of the working class.

STAVROS D. MAVROUDEAS

labour, international

GLOBALIZATION, characterized by highly mobile capital, has forced a re-evaluation of labour internationalism as the organized labour movement comes to terms with the new reality. Historically, COLD WAR divisions in international labour organization seriously weakened labour internationalism. In the post-war period, two organizations dominated the politics of labour internationalism. The World Federation of Trade Unions (WFTU) had comprised unions from the communist nations, non-aligned Third World unions and communist-led unions from Europe; whereas unions from West Germany, the United Kingdom, the United States, Scandinavia and Japan dominated the International Confederation of Free Trade Unions (ICFTU), the rival to the WFTU.

The collapse of COMMUNISM resulted in the decline of WFTU, leaving the ICFTU as the dominant player. The consequent closing of a bitter ideological divide occurred at a time when neo-liberal globalisation (see NEO-LIBERALISM) had consolidated the power of companies and undermined labour rights and union strength. Apart from a few notable exceptions, union densities are in decline everywhere. This crisis has generated debate over an appropriate union response to globalization. As a consequence, new forms of labour internationalism are being advanced

labour mobility

through theoretical debates and certain organizing initiatives.

Moody (1997) has argued for a global social movement unionism to challenge the logic of global restructuring. Initiatives to build new forms of labour internationalism include the World Works Councils promoted by certain of the International Trade Secretariats (ITS), which have close ties with the ICFTU. The International Transport Federation (ITF) has developed an effective transnational organization capable of responding to calls for action through its 'Ships of Shame' campaign, which fights for the rights of seafarers drawn from the Third World. In the 1998 maritime dispute in Australia, the ITF succeeded in organizing shipping boycotts against the offending company.

Globalization has heightened the dependence of nations on the smooth functioning of the trade system, thereby establishing objective conditions that could favour the growth of a new labour internationalism. New communication technologies provide real possibilities for a closer articulation of previously isolated, geographically distant unions. In considering the prospects for labour internationalism, these developments have to be weighed against the constraints. Neo-liberal globalization has strengthened capital's hand immensely. Doubtless, corporate power will refine its strategies against labour internationalism.

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ROB LAMBERT

labour mobility

Labour mobility has two sides: (1) the degree to which workers change their skills in response to variations in wages or job availability and (2) the rate at which workers move between

geographical areas in response to variations in wages or job availability. Labour mobility is important in the determination of the rate at which labour markets will adjust to equilibrium following a situation of disequilibrium.

Time is an important variable in considering labour mobility because, in the short-term, it is very difficult for people to change occupations, either due to ability or training. Over the long-term, however, mobility between occupations is very high. Time is less significant, however, for the rate at which workers move between geographical areas. Some barriers to labour mobility are man-made – for example, traders licensed to sell products in their local area, will presumably find it difficult to sell their products in a completely different geographical location with similar licensing laws.

See also:

wages

ALISON M.S. WATSON

labour relations

'Labour relations' is a controversial and contested feature of international trade relations that has long been a feature of trade debates. During the nineteenth century, European industrialization and the need for constantly expanding markets stimulated international trade relations linking metropolis to distant colony even more deeply. The intertwining of the economy of Britain with India and China, for example, where labour was plentiful and cheap, raised the issue of the possible impact of these changes on the condition of European labour in the minds of certain intellectuals and philanthropists. Individual bankers, industrialists and philanthropists expressed concern over the apparent human and social cost of these changes, arguing that the problem of labour-abuse needed to be included in all negotiations (Alcock, 1971). These individual moral interventions were ignored in the cut-and-thrust of

commercial trade deals generally shielded by state authority.

In 1881, articulation of the need for international labour standards (ILS) in trade relations moved beyond the moral reactions of individuals, as trade unions in the United States called on Congress to protect US industry 'from the cheap labour of foreign countries' (Charnovitz, 1987). Similar concerns were expressed at an international conference in Berlin in 1890 (Manhaim, 1934). Following World War I, the initiative for ILS shifted to European employers who argued for ILS legislation as they experienced international competitive pressures (Barnes, 1926; Ramm, 1986). Fear of Bolshevism and the radical currents sweeping the European working class gave further impetus to the concept of ILS as an element of a reformist response to these pressures. This took institutional form through the creation of the INTERNATIONAL LABOUR ORGANIZATION (ILO) in 1919. Article XIII of the Treaty of Paris that gave birth to the ILO was the first multilateral agreement to formally recognize labour standards as an international issue (Charnovitz, 1994). The turmoil of the GREAT DEPRESSION and the war years that followed constrained the role of the new institution (Eichengreen, 1992). However, the ILO was given fresh impetus following the 1944 Philadelphia Declaration, which consolidated policy commitment to international labour market regulation.

At the Thirty-First Session of the ILO in June 1948, the central role of free and independent trade unions in labour market regulation and the realization of ILS was asserted. The adoption of Convention 87 on freedom of association stated that workers and employers had the right to 'join organizations of their own choosing without previous authorization'. National states should not restrict this right. The right to freely associate was complemented by another Convention passed in 1949 on the right to organize and bargain collectively. This stated that any moves designed to 'promote the establishment of workers organizations under the domination

of employers organizations' would be deemed to have contravened this Convention.

This recognition of the ILS role of independent trade unionism was underpinned politically by the notion of a social contract between capital and labour and economically by Keynesian regulation of national economies (see KEYNESIAN ECONOMICS). The latter accepted a degree of trade regulation through tariff protection. However, the renaissance of liberal economies since the late 1970s has resulted in a sustained DEREGULATION thrust that has been driven both at the level of national states and at the level of new international agreements. The drive to extend and consolidate free trade through the substantial reduction of tariff protection, the deregulation of financial markets and the move to FLOATING EXCHANGE RATES was initially led by the industrialized nations, who are now pressurizing the developing nations to fully reform their economies in this manner. These shifts in national strategies have been consolidated through the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT), paving the way for the creation of the WORLD TRADE ORGANIZATION (WTO), which has enhanced powers to enforce free-trade rules.

The linkage of ILS to trade liberalization was on the agenda of the first meetings of the WTO (see LIBERALIZATION OF TRADE). The advancement of such linkage came from the US government, who were supported in this by a broad coalition of EUROPEAN UNION (EU) states and the International Confederation of Free Trade Unions (ICFTU). Earlier, the US government had actively campaigned for the application of ILS, particularly in the Asian region, in the form of a social clause that identified the recognition of certain core standards as essential to preferential access to the US market. This was a response to the demands of trade unions, community organizations and churches, which had argued that the denial of ILS had hollowed out American industry, undercutting wages, destroying jobs and letting conditions deteriorate. At the 1996 ministerial meeting of the WTO in Singapore, Asian governments vigorously opposed such

linkage, arguing that the imposition of such standards was disguised protectionism aimed at undermining the COMPARATIVE ADVANTAGE they derived from cheap labour. The final declaration of the WTO meeting, which was a compromise between these contending positions, shifted responsibility for the ILS to the ILO. Subsequently, the ILO has been striving to find a way of promoting ILS more effectively, given the constraints of the voluntarist status of their conventions. The ILO is presently considering the development of 'global social labels' that would identify countries that respect international labour rights. The United States is also promoting a 'code of conduct' for US companies.

An understanding of the international political economy of trade is critical to an informed assessment of these competing positions. This is because contrasting models of the relationship between labour standards and international trade each arrive at different conclusions regarding the impact the denial of ILS has on patterns of international trade and investment. First, the neo-liberal trade model has dominated thinking since the late 1970s (see NEO-LIBERALISM). In this model it is implied that labour standards are improved through free trade and economic growth, rather than through the intervention of states or international institutions which seek to promote ILS (Lambert and Caspersz, 1995). The central contention is that economic growth, powered by free trade, achieves a more rational ordering of the global economy through increased specialization and the operation of comparative advantage. These efficiencies translate into jobs and social progress. The imposition of ILS in the developing economies would deny them this opportunity by negating their prime source of comparative advantage – cheap labour. Within this model, the adoption of ILS is identified as a significant factor underlying the failure of industrialized nations to adapt to globalization. Such adaptation would require ILS restrictions to secure flexible labour markets in which working-time arrangements, wages and conditions could adjust more easily (OECD, 1994).

In contrast to the liberal model, alternatives informed by social democratic values emphasize the significance of ILS in international trade relationships. This has taken the form of the active promotion of a 'social clause' that specifies core labour-standards as a mechanism for regulating capitalist development and securing greater social cohesion. Reich (1991) has argued that such intervention could secure a 'positive economic nationalism' which 'eschewed trade barriers' while at the same time securing a more even development through the global implementation of ILS. The renaissance of regulation arguments has been strengthened by the emerging critique of the social impact of unrestrained globalization. New texts popularizing the critique point to dissolution of job security, growing inequalities and the declining commitment to welfare that has accompanied these changes (Martin and Schumann, 1996; Wolman and Colamosca, 1997). Whether this critique will result in a renewed political campaign for implementation of the social clause within the leading economies remains to be seen. However, regulation arguments in relation to other vital spheres impact on the terms of the discourse, thereby creating a more open climate for debate. There is evidence that the EU is continuing to search for new ways of pressurizing states that fail to comply with ILS, thus demonstrating the continuing influence of SOCIAL DEMOCRACY on European politics.

Clearly, ILS is likely to remain a contested feature of international trade relations. While all states have become locked into the logic of free trade governed by the WTO, the emerging critique of the liberal model of globalization opens new possibilities for assessing the role of labour in international trade.

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ROB LAMBERT

labour solidarity

The issue of labour solidarity is highly contested. Wide-ranging conceptual debates are grounded in complex changes in the structure, composition and consciousness of the working class under capitalist development (see CLASS, WORKING). The ideologically charged political conflicts in this area further complicate diverse approaches to the question of solidarity. Despite theorists who herald an 'end to history' (Fukuyama, 1989), the present era of GLOBALIZATION has often been marked by remarkable instances of labour solidarity that sometimes show signs of transcending national boundaries.

The writings of KARL MARX exerted a powerful influence in this area. His work has been the focus of considerable conceptual debate on the possibility of labour solidarity. Recasting the Hegelian interpretation of history, Marx's early philosophical writings emphasized the material basis of human emancipation. Capitalist development would produce labour solidarity. Having suffered 'a complete loss of humanity' through EXPLOITATION, workers would unite as they came to recognize that they had 'nothing to lose but their chains'.

Subsequent theoretical debate has revealed the inadequacies of this conception of labour solidarity. The assumption that an objective commonality of class interests ('class-in-itself') would lead inevitably to a solidarity consciousness ('class-for-itself') has been challenged. Labour solidarity is not inevitable. The capitalist labour process and labour markets segment and divide workers by creating distinctive interests and advantages. In the present era, new management strategies based on lean production concepts have deepened divides through outsourcing and the casualization of work.

It would, however, be foolish to regard labour solidarity as little more than a Sorelian myth - a utopian vision without the prospect of being realized. Such a conception throws little light on the rich texture of labour struggles that have characterized capitalist development. Labour history reveals instances of solidarity and instances of division that have been profoundly influenced by the strategic orientation of TRADE UNIONS and political parties. The task of analysis is to uncover both the objective and subjective conditions that produce labour solidarity and those that undermine its realization. In the 1990s, the general strikes in India against economic LIBERALIZATION, the Korean mass strikes in defence of lifelong employment and the Australian conflicts over union rights all indicate that the question of labour solidarity remains relevant to our understanding of contemporary economic and political change.

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ROB LAMBERT

labour theory of value

The 'labour theory of value' contends that the value of a good is the result of the labour expended in producing it. Classical political economists attempted to discover the origin and measure of value, leading them to posit labour as the prime factor.

ADAM SMITH recognized the role of labour in determining the value of a good. He proposed three different labour theories, but was often inconsistent in distinguishing between them. He presented the standard 'labour quantity theory', which suggested that the quantities of labour expended in acquiring different objects are the measure for their exchange. He offered a 'labour command theory' which suggested that the amount of labour a good can demand in the market determines its value. Finally, he propounded a 'labour disutility theory' which attempted to link value with the toil and trouble of the worker.

DAVID RICARDO criticized the adequacy of Smith's labour command and disutility theories as measures of value. He argued that value would vary with changes in the demand and supply of labour. Instead, Ricardo reasserted the importance of the labour quantity theory of value in terms of the amount of labour embodied in a commodity. He also undermined this theory, however, by suggesting that time-lags in bringing commodities to market could also affect their relative values. Additionally,

Ricardo argued that capital was a determinant of value, although not to the extent of labour. Consequently, some commentators argued that Ricardo had a 93 per cent labour theory of value with capital making up the other 7 per cent.

The labour theory of value was fundamentally modified by KARL MARX. Marx praised those political economists who examined labour as the basis of value, but suggested that their error lay in not properly analysing the 'form of value'. For Marx, unlike the classical political economists, exchange relations are the social form through which the labour of independent producers can be coordinated to satisfy social needs. Classical political economists saw exchange as an institution by which prices are mechanically derived from labour time. In contrast, Marx showed how exchange is a system of social relationships that is peculiar to a commodity-producing society such as capitalism. Value is therefore a social relation that expresses the portion of the total labour time of society allocated to producing a particular commodity – socially necessary labour time – and not the labour time embodied in a commodity. For Ricardo, value expressed the labour of the individual producer; for Marx, it expressed the labour of the producer as a member of society. Marx is offering, therefore, not a technical labour theory of value in the classical political economy sense, but is instead showing why labour takes the form it does in capitalism. Marx thus exposes how capitalism is a particular form of society that uses commodity production for the creation and appropriation of SURPLUS VALUE.

Although the labour theory of value (as interpreted by Marx) is still seen as a basis for Marxist analysis, the whole theory was attacked by the development of NEO-CLASSICAL ECONOMICS. Marginalists rejected labour as the basis of value and instead opted for utility. Additionally, post-Sraffians (see SRAFFIAN ECONOMICS) suggested that values played no role whatsoever in the analysis of exchange relationships and were therefore irrelevant. Consequently, the labour theory of value is

now used only by orthodox Marxist political economists.

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IAN FRASER

Lagos Plan of Action (LPA)

In response to the crises of debt and drought in the 1970s (see DEBT CRISIS), African presidents formulated the Lagos Plan of Action (LPA) in 1981 in the then capital city of Nigeria. The LPA constituted an indigenous reaction to the disappointments of independence and the pressures of extra-African forces, which were beginning to move in a neo-liberal direction – as in the simultaneous but authoritative Berg Report of the WORLD BANK on 'Accelerated development in sub-Saharan Africa'. Reflecting its nationalist and *dependencia* roots, the LPA favoured regional rather than global integration, but lacked both the economic resources and the political support to effect its ambitious goals. Its indigenous and radical inclinations have subsequently been articulated by the UNITED NATIONS (UN) in the Programme of Action, the New Agenda and the Special Initiative for the continent. Such directions are expressed in the declaration of and plans for an African Economic Community (AEC) at the beginning of the millennium.

See also:

African Development Bank (AfDB); African Development Fund (AFDF); United Nations Economic Commission for Africa (ECA)

TIMOTHY M. SHAW

laissez-faire

According to Frank Knight (1956), 'laissez-faire' is individual freedom over the choice of means and ends in a system of production and consumption. Laissez-faire's antecedents are found in French physiocracy and Anglo-Scottish moral philosophy. An explicit correlation between the economic self-interest of individuals and the public good was first made by Dr Bernard Mandeville in his biting satire *The Fable of the Bees*, in which he insisted that, paradoxically, 'private vices' (that is, everything done for selfish purposes) inadvertently resulted in 'public benefits'. David Hume and ADAM SMITH are to be credited with concretizing the laissez-faire doctrine, systematically applying the moral-philosophical argument to political economy by specifically advocating free internal and external trade. That said, they qualified laissez-faire by linking it to a secure legal framework, or what the Scottish thinkers called 'justice'.

Adam Smith held that 'natural liberty', or self-interested economic activity unfettered by artificial government restraints, had unintended and largely beneficial consequences for society, primarily in the increase of national wealth. The INVISIBLE HAND was Smith's metaphor for this self-regulating mechanism. At the same time, however, Smith and Hume were well aware that laissez-faire only produced a very imperfect harmony between individual and general interests. An appropriate institutional-legal framework was required to protect the individual's private sphere and arbitrate inter-individual and inter-group conflicts of interest. Consequently, the STATE was allotted a major third-party role in enforcing property and contract, which can be likened to an umpire or referee seeing to it that the 'rules of the game' are upheld.

A doctrine based on the universal harmony of interests and a minimalist 'nightwatchman' state were components of a 'pure' and unqualified laissez-faire, as advocated by the MANCHESTER SCHOOL of COBDEN and Bright. However, this was not the case with classical

liberalism, from Smith and Hume through the nineteenth-century English economists to twentieth-century classical liberals such as HAYEK, Knight, VINER and Robbins. All of them adhered to a laissez-faire bounded by the law and presupposing important and complex functions for the state in international relations, the enforcement of justice (that is, upholding property and contract, and preventing force and fraud) and the provision of public goods. It is also worth noting that the nineteenth-century English classical economists, from RICARDO, Torrens, McCulloch, Senior and the two Mills (see MILL, JOHN STUART) to Cairnes, Edgeworth and MARSHALL, took great care to distance themselves from the doctrinaire extremes of laissez-faire that had been resorted to by non-economist popularizers of the liberal creed.

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RAZEEN SALLY

Lakatos, Imre (1922–74)

Born in Debrecen in Hungary, Imre Lakatos left the country following the suppression of the 1956 uprising and settled in the United Kingdom. After joining the London School of Economics in 1960, he became a professor in 1969. He died at fifty-two, leaving a fragmented body of work made up mostly of essays and papers in the philosophies of science and mathematical discovery. For INTERNATIONAL POLITICAL ECONOMY (IPE), the most interest-

ing aspect of his work is the concept of the 'research programme' as an alternative to the more monolithic notion of theory.

Lakatos suggested scientific theories developed not only through Karl Popper's process of trial and error, but also by the juxtaposition of competing theories. Lakatos argued: 'It is not that we propose a theory and Nature may shout NO; rather, we propose a maze of theories, and Nature may shout INCONSISTENT' (Lakatos and Musgrave, 1970: 130). Each theory appeals to different evidence to explain a particular instance in its chosen field and thus competition between theories is not necessarily dependent on their treatment of the same collection of facts. Indeed, Lakatos adopted Quine's thesis that theories are not necessarily disproved by apparently inconsistent 'facts'. The comparison between the theory and a current set of facts will stimulate the seemingly anomalous theory to find further facts which support it. Inconsistent theories may therefore remain within a research programme until new facts emerge to dissolve the inconsistent elements and allow the theory's wider adoption. That theories might seek new facts is the key element of Lakatos' critique of Karl Popper's ideas about conjecture and refutation in which anomalous facts falsify theories. But, while Lakatos assumed that anomalies might not immediately compromise particular theories, he remained committed to some final link between the theory and the world it described. Theories might wait some time for their validating facts, but at some point they would need to establish their empirical validity.

For Lakatos, there are groups of theories which share a world-view – a parallel with Thomas Kuhn's idea of PARADIGMS. These groups are research programmes, each producing a multifaceted account of the issues around a set of core presumptions. Research programmes construct the context in which particular theories develop by setting out positive and negative heuristics. The negative heuristic is the research programme's central core. It is uncontroversial, accepted by all theories within the programme and not subject

to further research or dispute. The positive heuristic forms a 'protective belt' of theoretical accounts that flow from the acceptance of the negative heuristic. Elements of the programme which are accepted as subject to competing treatments are located in this outer belt. Therefore, anomalies may appear and different theories come into conflict outside the core, but still within the research programme. Lakatos stressed that to be useful a research programme must be progressive. It should have a higher empirical content than its predecessors, enabling it to account for some novel or unexpected facts.

Therefore, it may be appropriate to think of IPE as a research programme, rather than a subdiscipline of INTERNATIONAL RELATIONS (IR). The outline of a negative heuristic that might be accepted by all competing theories within IPE could be that economic transactions allocate resources and benefits; ECONOMIC POWER and political power are both implicated in these allocations; authority in the global system, however, is not necessarily dependent on national political resources, and therefore non-state actors play a major role in the international political economy. Around this negative heuristic revolve a competing and mutually inconsistent collection of theories. Thus, within the broad definition of IPE, there is inconsistency between (for instance) HEGEMONIC STABILITY THEORY and NEO-MARXISM, between MERCANTILISM and INSTITUTIONALISM. While all consider themselves to be broadly theories of IPE, each mobilizes different facts to explain the international political economy and accords importance to different specific issues.

The progressive aspect of IPE as a research programme would be the advance that it represents relative to mainstream IR. By introducing politics into accounts of international economics and economics into accounts of international politics, and (perhaps most importantly) by producing a new synthesis, IPE is progressive relative to both economics and politics because it seeks to account for more facts and causal links. Seeing IPE as a Lakatosian research programme helps distin-

guish IPE from IR and international economics, enabling IPE to develop its own character rather than being merely part of another discipline.

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CHRISTOPHER MAY

land reform

'Land reform' concerns the forms of agricultural ownership and production which emerge from the process of transition from FEUDALISM or the Asiatic system of communes to CAPITALISM.

Under the domination of feudal and Asiatic modes of production (see ASIATIC MODE OF PRODUCTION), the serf family and the commune respectively had the possession of the cultivated land. However, its formal property belonged (by customary LAW) either to the landowners (feudalism) or to the STATE (Asiatic communes) and therefore the peasants had to pay 'ground-rent' or 'tribute' for their possession rights.

Under feudalism, the ground-rent was initially 'labour-rent'. Later it was 'rent-in-kind' and finally 'money-rent'. Labour-rent absorbed the total of surplus-labour, whereas rent-in-kind (which presupposes a higher stage of economic development) might not include the entire excess labour. In the last case, the rural family might gain time for producing over and above its necessary means of subsistence, and so the possibility of differentiation among immediate producers and of commercialization of agriculture arose. The same possibilities were offered, too, by rent-in-kind under the Asiatic

late industrialization

state (where rent and tax coincided), on the condition that relative autonomy of the individual immediate producer as to communal collective possession pre-existed (for example, the communal property in Russia).

On the basis of these changes in agriculture – and of the development of trade, urban industry, commodity production in general and therefore money circulation – the rent-in-kind was transformed into money-rent. This pre-capitalist money-rent was the final form of pre-capitalist ground-rent. With money-rent, the traditional relationships of vassalage, which gave pre-capitalist social systems their coherence, were decomposed and the new monetary relationships (that is, the relationships which corresponded to the capitalist MODE OF PRODUCTION and its legal SUPERSTRUCTURE) appeared in agriculture.

In its further development, money-rent led (if intermediate forms such as share-cropping are not considered) either to the form of the capitalist mode of production or to the form of small-scale peasant ownership. In any case, the question about the prevailing form of agriculture into capitalism may be answered only by looking into the peculiarities of CLASS STRUGGLE in the field of a historical social formation.

The main presupposition for the prevalence of the capitalist mode of production in agriculture is the transformation of the actual cultivators into wage-labourers – that is, the peasants must be dispossessed of their land. They are then employed by the farmer (capitalist) who pays ground-rent in the form of money to the landowner (the proprietor of the land). Based on the class alliance between the bourgeoisie and the landowners, the British transition to capitalism was characterized by such an evolution from the end of the fifteenth century (the era of ENCLOSURES) till the first half of the nineteenth century (the abolition of the CORN LAWS).

Under small-scale peasant ownership, the peasants are the free proprietors of their land (no lease-price is paid) which they farm themselves. During the nineteenth and the first decades of the twentieth century, this form of free smallholding ownership arose out of the

dissolution of feudal and Asiatic landed property in France (where the bourgeoisie allied with the peasantry), in much of Germany, as well as in Central and Eastern Europe, including Russia, and in Mediterranean Europe (where the peasantry was preserved as an ally of the state and of large-scale agrarians).

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GEORGE E. ECONOMAKIS

late industrialization

The concept of 'late industrialization' emphasizes the capacity of less-developed economies to learn important lessons from the patterns of industrialization experienced by their more developed competitor economies.

Although a DEVELOPMENTAL STATE agenda for late industrializing economies was defined in the early nineteenth-century national political economy of FRIEDRICH LIST, the most influential modern exponent of the concept of late industrialization has been ALEXANDER GERSCHENKRON. His thesis of 'relative economic backwardness' has focused attention on the timing and rate of industrialization in a given national economy, delivering an explanatory synthesis which has emphasized not only the uniformities of the industrialization process across different economies but also the distinctiveness of particular national trajectories of industrialization in Europe and beyond (Gerschenkron, 1966).

Richard Sylla and Gianni Toniolo have identified seven hypotheses from Gerschen-

ron's analysis of late industrializing, relatively economically backward societies. These state that the more backward an economy, (1) the more rapid will be its industrialization, (2) the greater will be its stress on producer goods when compared with consumer goods, and (3) the larger will be its typical size of plant and firm; the greater the economy's emphasis on the latest technology, (4) the greater will be the pressure on the consumption levels of the population, (5) the less will be the role of the agricultural sector as a source of rising productivity and a market for industrial goods, (6) the more active will be the role of special institutional factors (notably the role of 'universal' banks in supplying investment capital and promoting industrialization), and (7) the more important will be ideologies of industrialization for shaping policies and events (Sylla and Toniolo, 1991: 5).

The concept of late industrialization has drawn attention to the developmental potential of the state and banking system as key agencies of industrialization for relatively backward economies. In South Korea, for example, Alice Amsden (1989) has identified a pattern of late industrialization in which a strong state has mobilized forces to inaugurate economic development, principally by intervening with subsidies to deliberately distort prices in order to stimulate economic activity and to impose performance standards on private firms.

See also:

advantages of backwardness

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SIMON LEE

Latin American Free Trade Association (LAFTA)

The Latin American Free Trade Association (LAFTA), created in 1960 to establish a COMMON MARKET, changed in 1980 into the Latin American Integration Association (LAIA).

N.M. DUYKERS

Latin American Integration Association (ALADI)

The Latin American Integration Association or Asociación Latinoamericana de Integración (ALADI) seeks to create a pan-regional COMMON MARKET for Latin America. It was formed in 1980 to replace the LATIN AMERICAN FREE TRADE ASSOCIATION (LAFTA), which worked to establish a free trade area for twenty years with little success. ALADI is the largest regional trade bloc in Latin America, encompassing Mexico and all ten countries of South America.

To implement its goals, ALADI follows a flexible and gradual INTEGRATION process, actively promoting bilateral, subregional and regional tariff and trade agreements among its members. The agreement also encourages members to seek trade agreements with non-members in Latin America, with other integration groups and with developing countries or groups outside the continent. Many countries participate in ALADI as observers, including Central American states, Cuba, Italy, Portugal, Russia, Spain, Switzerland and the EUROPEAN UNION (EU).

The organization recognizes the vastly different economic circumstances of its members by setting up different expectations and benefits according to its members' various levels of development. Member-countries are divided into three categories: most developed (Argentina, Brazil and Mexico), intermediate (Chile, Colombia, Peru, Uruguay and Venezuela) and least developed (Bolivia, Ecuador and Paraguay). Least-developed members receive preferential treatment in bilateral tariff agreements with more-developed members. For example, they are exempted from reciprocal tariff-lowering requirements and receive most-favored-nation (MFN) treatment in their trade with other members.

MERCOSUR and the ANDEAN COMMON MARKET are significant subregional trade organizations within ALADI that operate as single trading entities, granting no concessions or tariff reductions greater than those extended to other members of their respective organizations. The strength and momentum of these two organizations, especially Mercosur, have diverted much of the focus away from ALADI to other commitments. Thus ALADI's efforts to expand its role in Latin American economic integration have yielded few results. Although more than 23,000 tariff cuts have been made, intra-regional trade still accounts for only about 11 per cent of the members' total exports. It is still possible, however, that ALADI could play a strategic role as a bridge between the various trade agreements in the hemisphere.

WILLIAM P. AVERY

law

It is difficult to arrive at a meaningful definition of the term 'law' with which all (or even most) people would agree. This is especially true if focusing on the origins and underlying bases of law. Law is essentially a social institution of great complexity with many aspects, that is understood differently by different people and in different societies. Thus, the field of jurispru-

dence (the philosophy of law) comprises a number of different schools, each of which defines law differently. Another reason that it is difficult to define law is that the term takes on different meanings depending on the context in which it is used. For example, 'law' means something very different in the phrases: 'the law of diminishing returns', 'common law', 'martial law' and so on.

It is possible to come up with a more universally accepted definition of law, however, by focusing on the functions of law, rather than on its origins and meanings. As stated earlier, law can be thought of as a social institution that helps create, maintain and restore social order. Law has this essential function in virtually every society and social system. More specifically, one can identify three general functions of any system of law: to restore equilibrium to the social order, to enable members of the society to evaluate the consequences of their conduct, and to help formulate people's attitudes and conceptions of right and wrong.

- 1 Any society is fraught with disputes and other disruptions to the social order or equilibrium. While the Coase theorem postulates that many disputes can be settled efficiently by the parties to the dispute themselves, the conditions necessary for the Coase theorem to apply rarely exist. Thus, law arises in the first instance from claims made by one person or group against another – claims made in the name of social order. From the point of view of the injured party, the law serves as a mechanism for the satisfaction of financial loss or wounded feelings; from society's point of view, law serves as a means of reaffirming social norms which one person or group is threatening to violate. Further, the existence of law and the legal process prevents vengeance and sheer force from settling disputes.
- 2 By setting both standards of conduct and penalties for violations of those standards, law enables people to estimate the consequences of their actions. Although there are

other institutions in society that provide a similar function (for example, family, school, religious institutions and so on), the law can enable people to calculate the consequences of their actions when these other institutions fail – either because the situation and potential consequences are too complex or because there is disagreement between the people involved with respect to what is right and wrong.

- 3 Law also helps to educate the members of a society about what is right and wrong. Thus, law is a force that helps to shape the moral fibre of a particular society. Again there are the other institutions besides the law that help shape a society's concept of right and wrong, good and bad, and indeed law is less important than many of these other institutions. Nevertheless, it is clear that people derive their own notions of right and wrong, at least in part, from what society has determined as legal and illegal.

While the three functions of law discussed above exist in all legal systems, different societies place different emphases of each of them. For example, the function of satisfying injured parties is more acute in societies in which violence is widespread, whereas the function of educating people's legal and moral conceptions is more acute in societies characterized by relatively weak and paternalistic non-legal systems of education. Furthermore, the relative importance of these functions also differs within any legal system. In the United States, for example, the criminal system places great emphasis on the satisfaction of the community's sense of outrage, certain components of arbitration systems are geared more towards educating the parties, while the commercial law emphasizes the security and certainty of transactions.

Finally, while the three functions of law discussed above are universal to all systems of law, each legal system has its own unique functions as well. For example, in virtually all Western legal systems, another crucial function of law is maintaining historical continuity and consistency of doctrine. Thus, Western law

must be viewed as the unfolding of ideas in history, as well as a response to social conditions.

See also:

law, economic role of

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STEVEN E. ABRAHAM

law, economic role of

Although classical economists (and especially ADAM SMITH) had extensively discussed the economic role of institutions (and of law in particular), neo-classical economists set aside institutional factors, treating law as an exogenous factor for economic decision-makers (see NEO-CLASSICAL ECONOMICS). For economists, the legal environment was relevant but given, and the legal institutions were mere constraints, outcomes of an arbitrary political will. Despite the work in the area by great thinkers like Smith, KARL MARX or MAX WEBER, and the overlooked work of the old institutional school (see INSTITUTIONALISM), there was little progress in the field prior to the publication of a seminal paper by Ronald Coase in the early 1960s and an influential textbook in the early 1970s by lawyer-economist Richard Posner (see Coase, 1960; Posner, 1998 [1973]).

Marx and Weber

Marx viewed law as an instrument of class oppression, since it served the interests of the dominant class. Since Marx, scientific Marxism has emphasized the importance of class-based ownership of the means of production (and the social relation and structures that follow) for the determination of the content of political, legal and other ideas. Weber, following Marx, treated law like a cornerstone of CAPITALISM, but his views were more positively inclined. For Weber, law was the most important factor in the rationalization of Western societies, as an integral part of the rational-legal form of domination (*Herrschaft*, which is the legitimate exercise of power in Weber's conceptual system).

Institutionalism

At the dawn of the twentieth century and especially in the 1920s, institutional economics criticized orthodox neo-classical economics for its overly simplistic and abstract mathematical models and its neglect of the institutional

environment. The work of Robert Hale, John Commons and (much later) Warren Samuels laid the foundations – together with the kindred 'legal realism' movement – for the examination of legal institutions through the application of economic theory. However, the old institutionalist school did not succeed in displacing neo-classical economics for two reasons: (1) its models were too rich in comparison to the abstract but more functional models of the neo-classical school and (2) it lacked the sophistication of neo-classical economics, which managed to incorporate some of the insights of INSTITUTIONALISM and refine its models.

The Coase theorem and the neo-institutional school

In a seminal article published in 1960, Ronald Coase, dealing with the problem of EXTERNALITIES, formulated the now famous Coase theorem: if PROPERTY RIGHTS are well-defined and enforceable, and there are no transaction costs, then there is no misallocation of resources because of externalities, since the property right will end up in its most highly valued use. This theorem had great repercussions on legal theory, but also on the economic approach to the role of law in SOCIETY. According to the positive version of the Coase theorem, the ultimate result (which maximizes the value of production) is independent of the legal assignment of rights (the rules) if the pricing system is assumed to work without cost. That is, if market transactions are costless, there is no effect on the allocation of resources, regardless of the allocation of legal rights.

But Coase himself admitted that the absence of transaction costs was a very unrealistic assumption. Thus, in the same paper, he set forth the normative version of the Coase theorem: Once the costs of carrying out market transactions are taken into account, it is clear that the initial delimitation of legal rights does have an effect on the EFFICIENCY with which the economic system operates. This was a groundbreaking conclusion for both law and economics.

The work of Coase led to the birth of a neo-institutional school, which emphasized the role of institutions as important factors for economic performance (since they structure economic incentives). Neo-institutional economists (Douglass North, Oliver Williamson and many others) focused their work on property rights, contracting and transaction costs. For North (1990), property rights constitute the central component of the institutional environment and set the parameters for the contracting process by establishing incentives and constraints for individuals. Thus, contracts reflect the opportunity sets and incentives embedded in the existing property rights structure. Furthermore, the existence of transaction costs leads to governance structures which are more efficient than market organization, because of the incomplete planning and incomplete contracts (due to bounded rationality, opportunism and ASSET SPECIFICITY). Neo-institutional economics, at its peak at the end of the twentieth century, has managed to exert considerable influence on the mainstream and continues to do so.

Economic analysis of law

In his seminal paper, Coase had observed:

It is clear that an alternative form of an economic organization which could achieve the same result at less cost than would be incurred by using the market would enable the value of production to be raised.

(Coase, 1960: 16)

Coase had in mind his 'theory of the firm'. He had also suggested that courts should understand the economic consequences of their decisions. However, since Coase had no interest in law, it took the jurist (with a passion for economics) Richard Posner to establish a new discipline by suggesting that courts should 'mimic or simulate the market' in order to achieve the efficient allocation of resources. Since the initial assignment of rights is instrumental, legislatures and judges should consider the potential impact of alternative rulings on the future behaviour of individuals. Posner has

also formulated the 'efficiency theory of the common law', according to which many areas of the law (especially common law) bear the stamp of economic reasoning – that is, many legal doctrines have an economic rationale.

Efficiency and the free market do not suffice

In an as yet unpublished paper, the late MANCUR OLSON and Avinash Dixit criticize the Coase theorem, by insisting that the free market and competition are not sufficient for economic growth. They argue that the structure of incentives in the political system and the economic understanding of a nation's elite have a major impact. For Dixit and Olson, if outcomes were not dependent on economic policies and on the institutional structures and elite opinions that help to determine them, then per capita incomes across the countries of the world would, to an approximation, be given by each country's inherent endowments of natural resources and human capital. But per capita incomes are decidedly not determined mostly by endowments: that per capita incomes are more than twenty times larger in some countries than in others is due in large part to differences in their institutions and economic policies.

See also:

Chicago School; democracy and economic growth; economism

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ARISTIDES N. HATZIS

law, international

International law is a system of norms which exists between states (see STATE, THE) and

other international actors, including international institutions and (to a limited extent) individuals. It governs issues as diverse as the use of force, the regulation of international telecommunications, human rights and the law of the sea. It is a decentralized system of law created by states, primarily in the form of international treaties and customary international law. It is also enforced by states, giving rise to the concern that international law lacks imperative character and is irrelevant to the conduct of INTERNATIONAL RELATIONS (IR).

On the contrary, however, states do accept that international law is binding on them. There are a number of reasons for this, relating in large part to the consensual nature of international law and the apparent need for states to be part of an ordered, albeit decentralized, system. Thus, states follow international law because they are inclined to do so (law habit), or because of the fear or hope of reciprocal action, or because of public opinion (both domestic and international). Mechanisms do exist for the centralized enforcement of international law through the organs of the UNITED NATIONS (UN). However, use of these has been limited by both political and economic concerns.

Clearly international law is a weak system of law. However, it exists as a system of norms which is, at least, capable of influencing state actions. At best, international law is capable of having a determinative role in the international relations of states.

See also:

law, economic role of; World Trade Organization (WTO)

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J. CRAIG BARKER

LAWS OF OLERON *see* Oleron, laws of

leading sectors

The fundamental idea underlying the 'leading sector' concept is that any economy is characterized by sectors of varying production activity and overall significance. Some sectors not only grow rapidly but also have major implications for accelerating the growth of the macro-economy. This type of sector is linked directly to the claim that long-term ECONOMIC GROWTH comes in temporal and spatial spurts and is carried by specific and radical breakthroughs in commerce and production in certain sectors. Some authors refer to the advent and institutionalization of these major and new growth spurts as 'technological regimes' or 'trajectories', and (more recently) the term 'general purpose technologies' has also appeared. Even though very specific industries – such as cotton textiles, iron, railways, steel, electrification, cars, aerospace and computers – are often suggested as examples, they are only examples and (at best) indicators of technological sources of discontinuous and long-term growth. No one argues, for example, that the railways – a critical nineteenth-century leading sector – were the sole driver of long-term economic growth in that century. Rather, the railways epitomize a mid-nineteenth-century wave of innovations, in part connected with advances in steam propulsion. The growth rate of railways, therefore, may serve as a proxy for radical technological change in this period.

The customary application of the leading sector concept is restricted to the British INDUSTRIAL REVOLUTION and the period that followed. The customary sequence of development roughly follows the progression from cotton textiles to the information age suggested above. However, it is possible to utilize the concept over a longer period by applying it to shifting emphases in commerce (for example, spices, sugar and tobacco) or even to basic shifts in modern economic growth (such as the movement towards economic monetarization) or new emphases on long-distance commercial activities (such as those that took place in Sung China between the tenth and twelfth centuries). Such an interpretation can produce a millennium-long sequence of leading sector growth, from Sung China in the tenth century through other pioneering economies (Genoa, Venice, Portugal, the Netherlands, Britain and the United States) to the current period, characterized by some level of uncertainty about precisely which sectors are leading or will lead and where they are or will be concentrated spatially – if indeed they will continue to be highly concentrated as in the past.

Regardless of which historical script is adopted, the underlying assumption of leading sector interpretations is that new technology comes in clusters, is concentrated initially in some specific sectors, diffuses throughout a pioneering lead economy and then spreads selectively to relatively receptive areas in the rest of the world. In this respect, the lead economy plays a role in the world economy that is similar to the role of leading sectors in national economies. Leading sectors and the world's lead economy in any given era are thus primary drivers of economic growth. Empirically, this contention has been validated for US leading sectors in the post-World War II era. US leading sector growth caused US aggregate economic growth and the world economy's aggregate growth, but not without reciprocal causation taking place as well. Obviously, leading sectors are not the exclusive drivers of economic growth, but their impact is viewed as both fundamental and critical.

One would be hard pressed to describe the

least-developed countries (LLDCs)

concept of the leading sector as prominent in the mainstream literature. One reason is that most models of economic growth either leave TECHNOLOGICAL CHANGE as a residual category, or do not deal with technological change in specific sectors. Instead, emphasis is given to the role of variables such as POPULATION GROWTH, capital accumulation, INVESTMENT, saving and education. To the extent that sectors are differentiated, the distinctions are apt to be both more generic and more standardized, as in the traditional cases of labour, land and capital, or industrial and agrarian sectors. In this context, the notion that specific technologies play significant roles in specific times and places (and are less significant at other times and places) is thought to be both atheoretical and anecdotal.

A second reason for the leading sector concept's low profile is that most of the few economists who have taken long-term growth periodicities seriously enough to examine the evidence have come away unpersuaded by the claims for technological etiologies for periodicities. The question is not whether there appear to be alternating phases of slow and rapid economic growth; rather, the question is whether there is sufficient evidence to link the slow and rapid phases to clusters of technological innovation. The mainstream answer to questions pertaining to propensities towards discontinuous growth has tended to fall back on accidental, random or *ad hoc* disturbances. Analysts of leading sectors, however, see little randomness or '*ad hoc*-ery' in the well-documented coming and going of radical changes in prevailing technology. The empirical challenge remains one of demonstrating specific and observable linkages between new technology and consequent economic growth.

Further reading

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WILLIAM R. THOMPSON

least-developed countries (LLDCs)

By its 1971 resolution, the United Nations General Assembly recognized the existence of a category of countries characterized by severe economic and social problems, notably the profound poverty of their people, the weakness of their economic, institutional and human resources and, in some cases, major handicaps caused by geography (such as landlockedness). The question of identifying a category for the poorest among the poor has a long history. Indeed the terms 'least-developed countries' or 'most disadvantaged countries' were already in use before any list of such countries, or any criteria for designating them, had been

adopted. However, the category officially underlines the fact that not all DEVELOPING COUNTRIES are similar. At the same time it reflects the willingness of some developed countries to offer selective trade and aid preferences. Despite early criticism from both developed and developing countries of the choice of criteria and the countries so designated, it is now widely recognized that the category has proved to be a useful policy tool.

Three criteria are used to identify least-developed countries (LLDCs): per capita GROSS DOMESTIC PRODUCT (GDP); contribution of the manufacturing sector to GDP, and adult literacy (the age group being fifteen years and over). Both the thresholds and the list of countries are regularly re-examined. The rationale behind these indicators is to quantify poverty in a simple and straightforward way. The per capita GDP represents a 'rough-and-ready' indicator of the local productive capacity, the share of manufacturing gives an idea of the structural transformation of the economy, while the adult literacy rate suggests the extent of the human resource base. Currently, forty-eight countries with a combined population of 596 million (1996 estimate) are identified as LLDCs. Of these, thirty-three are in Africa, nine in Asia, five in the Pacific Basin and one in the Caribbean. Geographically, fifteen are landlocked countries and eleven are islands. A more complex index developed by the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), based on a large number of indicators, produces practically the same list of countries.

In addition to the criteria adopted, LLDCs have a number of other characteristics. One is extremely low economic growth rates coupled with high rates of population growth. The vast majority of their populations is typically engaged in agriculture, primarily subsistence agriculture, and lives in rural areas. At the same time, they often have poor transport and communications. Practically all of them are dependent on imports for the bulk of their consumption, as well as capital goods, while exports (generally of primary products) do not generate enough foreign exchange for their

import needs. Savings and investments are extremely low as well. As a result, they lack the necessary finance to sustain their development effort and often are heavily indebted. They also tend to suffer from malnutrition and shortages of drinking water. Their problems are compounded by the depletion of non-renewable natural resources. Because of public finance shortages, health services and education systems are often rudimentary. LLDCs represent a major economic and social development challenge, both to their own policymakers and to the donor community.

See also:

less-developed country (LDC) debt management

Further reading

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LUCA MONGE ROFFARELLO

legitimacy crisis

It can be argued that, as an increasing number of activities come to be perceived as the responsibility of the STATE, attempts to justify the existence and power of governments or social systems become more difficult. Survival depends not only on the ability to regulate economic activity, but also on how political, social, environmental and ideological problems are handled. Failure to meet varied demands can result in the state losing popular support, with the social cohesion of society being

lender of last resort

undermined. The challenge to the way society is organized may provoke the state to resort to the use of force to reassert its authority. Fear of the collapse of the system may also trigger a drive towards the diminution of the functions of the state ('rolling back the state') as a way of facing up to the legitimacy crisis. Despite these efforts, disenfranchised citizens may disengage themselves from the state, swelling the ranks of CIVIL SOCIETY and undermining the legitimacy of the state.

Habermas (1973) identifies the increasing reliance on ideological forces in 'late capitalist societies' as central to how the state legitimizes its continued role. Others contend that the state can play off one group against another, forming alliances with certain (strategic) groups at the expense of the more vulnerable ones and thus fragmenting opposition. But since the outcome of these struggles is uncertain, the playing out of these conflicts may give rise to extra-parliamentary groups which may pose a threat to the whole system.

These issues have served, among other things, to reopen the debate about the role of administrative bureaucracies in legitimizing African states. At independence, the legitimacy of the new rulers derived as much from the legacy of colonial (and even pre-colonial) times as from the promises of a new 'socialist' order. Nationalists could justify intolerance of dissent on the grounds that they were defending the building of a new society from 'counter-revolutionaries'. However, economic development soon proved to be a contradictory and painful experience. Effective democratic controls were curtailed, or even eliminated, while the failure to meet promises (the crisis of expectation) led to challenges to incumbent regimes by those who were denied access to state resources. Patron-client relationships also led to corruption, thus generating instability.

These developments have brought accountability and the conflict between state and civil society to the fore (Chabal, 1994; Gordon, 1996). The political and economic problems in Eastern Europe, together with the difficulties associated with reform, have also raised the stakes with regard to democratization, citizen-

ship, employee and property rights, and the relation of cultural and national identity to questions of legitimacy.

See also:

capitalist crisis; embedded state; fiscal crisis

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TIDINGS P. NDHLOVU

lender of last resort

One of the functions of a central bank is to be a 'lender of last resort'. The idea is usually attributed to Walter Bagehot (1826-77), who argued that financial crises could be defused successfully by a lender of last resort that, in the face of a panic, would provide credit in exchange for good collateral at a high rate of discount (see FINANCIAL CRISIS; FINANCIAL PANICS AND CRISES). If a financial panic is a flight to liquidity in a dangerously uncertain situation, then a guarantee of liquidity would deflate the issue safely, Bagehot argued. It is today widely understood that a domestic

lender of last resort can cut short financial crises and moderate their effects. The claim that the very existence of a lender of last resort in fact prevents crises from forming remains controversial, however, since it tends to encourage riskier investment behaviour (what economists term MORAL HAZARD) and expand the speculative domain, increasing the potential for financial crises.

MICHAEL VESETH

lending

'Lending' is one side of an inter-temporal exchange of resources. The lender provides a sum of money to the borrower, who promises to repay the money, usually with interest, on specified future dates. In terms of scarce resources, the lender yields command over current resources in exchange for the borrower's promise to provide resources in future periods. Foreign lending produces debit items in the capital account of a nation's BALANCE OF PAYMENTS; monetary outflows (debits) are exchanged for promised future repayment, which is an asset. A nation that is a net lender thus tends to have a capital account deficit.

MICHAEL VESETH

lend-lease

The Lend-Lease Act of 1941 officially committed the United States to the cause of the Allies in World War II, well before the United States formally entered the war. The act permitted the United States to assist other countries that were important for US security. Lend-Lease was part of President Franklin D. Roosevelt's strategy of helping the British in the war with Germany. The British were unable to pay for arms and the United States was officially neutral. In keeping with his call to make the United States the 'arsenal of democracy', Roosevelt called on Congress to pass a lend-lease law. Advocates of the act saw it as a

way of keeping the United States out of the war. The act gave the president authority to 'lease, lend, or otherwise dispose of' up to US\$7 billion worth of arms to any country whose defence was vital to the United States. The amount authorized was spent almost immediately, demonstrating the Allies' need. The act was interpreted by many at the time as an official end to US isolationism during the inter-war period, albeit a modest end from the perspective of those calling for more robust participation of the United States in the European war.

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PAUL G. HARRIS

Lenin, Vladimir Ilich (1870–1924)

Vladimir Ilich Ulyanov (Lenin) was the leader of the BOLSHEVIK Party that unleashed the October Revolution in 1917 and subordinated the other Left parties a year later. He became the first government leader of revolutionary Russia and was the inspirator of the Communist (Third) International set up in 1919 (see COMMUNISM). Often considered primarily a practical politician and tactician, Lenin's revolutionary views and actions were rooted in a creative application of Marxism (see MARXISM–LENINISM). His writings fill forty-five volumes of the *Collected Works* edition (Lenin, 1960–70).

Lenin's major contributions to international political economy (IPE) are in two related

fields. One is IMPERIALISM, the political and economic expansion of the major capitalist states and firms into their periphery and the concomitant struggle between them over contested arenas for expansion. The second is the debate on how demands for national self-determination were to be dealt with should socialist revolution come to multinational empires such as Russia or Austria (see NATIONALISM).

Lenin was preoccupied (obsessively some would say) throughout his life with the idea of working class revolution. The two areas in which his importance as a theorist of IPE is greatest both offered new and intensely debated possibilities for revolution, as well as obstacles to it. The obstacle that imperialism placed in the way of a workers' revolution was the chauvinism which rivalry over foreign expansion instilled in the population at large. The opportunity it offered was that, in the case of war over contested spheres of influence, the economic and political links connecting the major states into rival alliances would collapse and expose the weakest states among them to a well-organized proletariat. National self-determination likewise could turn into an obstacle to revolution if the workers' party was negligent about demands for autonomy, often felt deeply among the oppressed nationalities; but if approached correctly, workers' support for national independence could on the contrary broaden the alliance of forces which the proletariat was to lead towards socialist revolution.

Before turning to imperialism and self-determination in more detail, a biographical outline of Lenin's political and theoretical development may provide useful background.

Political and intellectual development

Lenin was born Vladimir Ilich Ulyanov in 1870, in Simbirsk, Russia (later named Ulyanovsk in his honour by the USSR), into a well-to-do family. His father, a school inspector, died when he was sixteen; his elder brother was hanged a year later for involvement in an attempt on the life of Tsar Alexander III. Lenin

studied law at Kazan University in 1887, joined a Marxist circle and was expelled from the university for political activity after one year. After a short experience as a practitioner in law in Samara (Kuibyshev in the USSR), he moved to St Petersburg (Leningrad in the USSR). There he and Julius Martov, his future opponent, organized the illegal Union for the Liberation of the Working Class, which was involved in the 1896 textile workers' strike. Lenin by then had already been arrested and was exiled to Siberia for three years. In exile, he married his companion N.K. Krupskaya. Meanwhile, the Russian Social Democratic Labour Party formed in 1898 had become subject to intense persecution. On his release from exile, Lenin emigrated to Switzerland where he set up the newspaper *Iskra* ('the Spark') with his mentor, Georgi Plekhanov, in 1900. Except for a return during the 1905 revolt, Lenin would remain in exile until 1917.

Lenin's political activity was initially directed against the *Narodniki*, the friends of the people – a populist current in the Russian revolutionary movement. The Narodniks held that the traditional Russian village community was preferable to industrial society as a basis for socialism. From that vantage point, they resisted the coming of capitalist relations. In *The Heritage We Renounce* (1897–8) (ibid.: vol. 2), Lenin sought to demonstrate that the Russian village in reality was the breeding ground of superstition and backwardness. In *The Development of Capitalism in Russia* (1899) (ibid.: vol. 3), he set out to demonstrate that capitalism was already an irreversible reality in Russia as well. This study is still of methodological value for understanding the growth of capital in a big, late-developing country and the condition of the peasantry in it. Lenin shows that aggregate statistics for Russia understated the real shift to an urban, industrial economy: first, because of the vast migrant workforce which, due to mobility restrictions, worked in industry on a seasonal basis only and which was not counted as urban; second, because the internal colonization of virgin land promoted a fresh increase in the landed population. Lenin also rejected the

thesis that capitalist development in Russia would fail because of the limits of the internal market. Capital accumulation creates its own market, primarily for investment goods; the limited capacity for consumption due to mass poverty is not a specifically Russian factor, but a contradiction governing capitalism generically and driving it forwards to global expansion (see UNDERCONSUMPTION). While foreign trade is a historical given, it is not a necessary precondition for capitalist development as the Narodnik economists argued.

Lenin took an uncompromising position on the historical role of the proletariat. In the unevenly developed Russian social formation, however, the workers could not directly aim for a socialist society (see SOCIALISM). Therefore (given the prevailing conditions of repression and illegality as well), they should be organized by a proletarian party of professional revolutionaries who would mobilize the forces of resistance and revolution as broadly as possible, but in the full awareness of both the potential and the limits of revolutionary change. Such a party also should prevent the workers from being bought off by temporary concessions and from adopting a trade-unionist view of their position relative to capital, rather than aiming for an overthrow of capitalist society. These ideas were laid down in *What Is To Be Done?* (1902) (ibid.: vol. 5). At the Second Party Congress in 1903 (begun in Brussels, then moved to London), two tendencies crystallized over party organization: Lenin's Bolsheviks (so-named because they were the majority at the party congress) versus Martov's MENSHEVIKS (minority). In 1912, Lenin would actually purge the Mensheviks at a party conference in Prague.

Lenin's confidence in the power of Marxism, and his orthodox adherence to it, earned him the reputation of a 'political Jesuit' among even his closest associates. In fact, until 1914 the Marxism from which he drew inspiration to engage in his tireless diatribes against political rivals was a materialist, deterministic version which holds that all reality is ultimately made up of matter. Consciousness in this perspective is determined by objective reality, essentially

because that reality is reflected in the human brain. However, MARX (in his critique of Ludwig Feuerbach) had argued that materialism *per se* is an inadequate critique of (religious or philosophical) idealism, because it fails to account for the moment of creative social development that distinguishes human history from physical processes. HISTORICAL MATERIALISM indeed holds that consciousness does not emerge by reflection, but represents an activity structured and bounded by a historical type of society through which the concrete experience of the real is mediated. Yet, when Lenin thought he had detected a source of idealist regression in the claims of the new natural science that what it deals with are sense experiences rather than actual 'matter', he mounted the attack on Mach, Avenarius and others by reference to a materialism largely in the spirit of Feuerbach. Significantly, it was this study, *Materialism and Empiriocriticism* (1909) (ibid.: vol. 14) that was elevated in the Soviet Union to become the canon of Marxist philosophy.

The implications of materialist Marxism are many, including a unilinear relationship between basis and superstructure, and economic determinism (see DETERMINISM, ECONOMIC; SUPERSTRUCTURE). The latter holds that the economy develops by objective laws, while politics is rather a part of the sphere of reflection. This may equally induce a passive attitude in matters of political action – encouraging people to wait for objective conditions to mature (an approach favoured by KARL KAUTSKY) – or a voluntarist activism (of the type that Lenin advocated). However, although he was predisposed to such activism by temperament and admiration for the vanguard role of the Jacobins in the French Revolution, Lenin shared the idea that economic development evolves in necessary stages that each country has to pass through (see ROSTOW, W(ALT) W(HITMAN)). Hence, his conviction that the Russian proletariat had to be first guided through the democratic revolution by a conscious vanguard, before it could make its own revolution.

When World War I broke out in August 1914, the European socialist parties (despite solemn commitments to the contrary) voted for war by overwhelming majorities. When the news that even Plekhanov, his revered mentor, had called on the Russian workers to defend the motherland, reached Lenin in his Swiss exile, he was devastated. Characteristically, he then turned to a renewed study of the sources of Marxism (such as G.W.F. Hegel's *Science of Logic* and other philosophical works), writing the collection of glosses, comments and brief digressions which later were published as the *Philosophical Notebooks* (ibid.: vol. 38). These notes led him to abandon the deterministic materialism for a more dialectical, holistic view, in which the making of history is placed in the context of world development as a whole.

In April 1917, Lenin was allowed by the German High Command to travel back to Russia in a sealed train, as the Germans considered him and other revolutionaries and separatists to be useful for creating havoc behind Russian lines. Being the only Left leader who continued to campaign for laying down arms, even when the new provisional government installed by the February Revolution called for continuing war, Lenin's reputation rose when the July offensive ended in disaster. In his 'April theses' (ibid.: vol. 24), Lenin called for an armed uprising. Direct democracy of workers and peasant-soldiers through the *soviets* (councils) should replace parliamentary representative democracy which is divorced from economic control. He urged the peasants to seize the land from the big proprietors and encouraged those still serving in the battered armies to break ranks and join the movement of land seizure. Again in hiding to escape arrest, Lenin wrote *The State and Revolution* (ibid.: vol. 25), in which he prophesied that following the period of dictatorship of the proletariat organized in soviets – necessary to disarm the enemies of the revolution – the state would 'wither away' as no separate coercive apparatus would be required in a society without classes. In *The Impending Catastrophe and How to Combat It*, written in the same period (ibid.: vol. 25), Lenin argued

that state centralization of the war economy had already materially prepared socialism. Then, on the night of 25 October 1917 (or 7 November by today's calendar), the Bolsheviks seized power in Petrograd, followed by uprisings in other major cities.

Once in power as Chairman of the Council of People's Commissars, Lenin matched a capacity for subordinating every issue to the cause of the international revolution with dealing ruthlessly with those who resisted Bolshevik power at home. In March 1918, he forced his fellow Bolsheviks into accepting a humiliating peace with the Germans, who had unleashed a lightning offensive, routing the disintegrating Russian armies. Simultaneously with the Brest-Litovsk Peace, the Bolsheviks had the new Constituent Assembly (in which they had won 25 per cent of the vote) dispersed by communist sailors. Lenin then moved to set up a political police, the CheKa, to watch over both the enemies of the revolution and the newly disenfranchised Left allies. In the civil war against the Whites (led by Tsarist generals and backed by foreign intervention), the Red Army under Leon Trotsky (1879–1940) was eventually successful: the peasants on the whole did not want the return of the land-owners, while the foreign armies had little resolve left to crush the Bolsheviks.

The civil war, in addition to the losses of World War I, left the country exhausted. With resistance to Bolshevik centralization growing (dramatized in the Kronstadt sailors' revolt), Lenin then launched a NEW ECONOMIC POLICY (NEP) in 1921, terminating radical 'war communism'. By allowing limited private enterprise again, the NEP was intended to allow the people a breathing space, but also to regenerate (along with reviving the national economy) the proletariat which had melted away in revolution and war. Lenin, suffering from the consequences of an attempt at his life in 1918, in December 1922 had to discontinue his work in the government. He died in 1924 in Gorky, near Moscow. In his last writings, he warned against bureaucratic tendencies in the party and the state, and in a 'testament' recommended against allowing Stalin to be-

come his successor, preferring Trotsky instead. Lenin's body was embalmed for display in a mausoleum in the Kremlin wall. His last will, by means of a compromise within the leadership, was not made public and Stalin was able to consolidate power on Lenin's death by playing the Bolshevik old guard off against one another, eventually destroying them (see STALINISM).

Imperialism

During the late nineteenth and early twentieth centuries, the phenomenon of new forms of INTERNATIONALIZATION of capital, a concomitant scramble for colonies by the major powers (see COLONIALISM) and rivalry over foreign spheres of influence from the turn of the century onwards, increasingly occupied labour leaders and socialist thinkers.

For Lenin, the overriding concern was what he saw as the infection of the working classes with chauvinist sentiments that undermined their revolutionary resolve. In his analysis of imperialism, however, we also find the traces of a new understanding of historical materialism and dialectics. Thus, the idea that every country passes through fixed stages of social and political development (feudal-absolutist to bourgeois to socialist) was now dropped. Imperialism stood for a world-embracing complex of forces, to which every national history is subsumed; every national labour movement had to define its own position, opportunities and tasks in this global constellation with an eye to the triumph of socialism on a world scale.

Lenin's ideas in this area were influenced by others, notably Trotsky, who in his reflections on the 1905 revolt already began to doubt whether Russia really would have to experience a bourgeois revolution first. From him, Lenin took the idea that the strength and resolve of the Russian proletariat qualified it as a vanguard force capable of driving global development forward in a chain-like 'permanent revolution'. National revolutions, whatever their internal sources and orientation, in this perspective become part of a global process

necessarily determined by and drawn into its most advanced form – that is, socialist revolution. This, of course, implied that the working class should not be deflected from its revolutionary internationalism by the reformism or chauvinism that had already captured it in 1914. Kautsky in that year even prophesied that capitalism after the war could unite into a global ULTRA-IMPERIALISM, sharing the world's agrarian countries among the industrial powers.

In Lenin's view, the ultra-imperialism thesis encouraged the workers to think that a capitalist future was still feasible, condemning them to live through more and bloodier wars in the future. Already in his 1915 preface to *Imperialism and World Economy* (1972) by N.I. BUKHARIN, he took Kautsky to task for it. Where Bukharin sought to demonstrate that imperialism resulted from the coalescence of state and capital into what he called 'state-capitalist trusts', Lenin attacked the very idea of any stable arrangement under imperialism – be it 'ultra-imperialist' or, by implication, state-capitalist. While he concedes that, abstractly speaking, the world is on its way to complete unification under a 'world trust' that will transcend competition, this development is proceeding so fast, under such pressure, with such contradictions and convulsions – not only economical, but also national and political – that before the single world trust could be reached and an 'ultra-imperialism' achieved, imperialist capitalism would explode.

In 1916, Lenin wrote *Imperialism: The Highest Stage of Capitalism* (ibid.: vol. 22; from materials published posthumously as *Notebooks on Imperialism*, ibid.: vol. 39). The subtitle emphasized that imperialism marked a final crisis of capitalism, expressed in declining rates of innovation, war and the immediate prospect of socialist revolution. A pamphlet in tone and form, it was based on extensive study and wide reading, and combines (without due reflection perhaps) the theories on imperialism by J.A. HOBSON and RUDOLF HILFERDING. Hobson proceeded from the British situation, in which independent financiers backed piratical overseas projects, such as Cecil Rhodes'

South African adventures, to the detriment of domestic industry's interest in a strong home market and stable exports. Hilferding, on the other hand, elaborated on the situation prevailing in Germany and Austria, where investment banks operated in tandem with heavy industries to which they were linked (by participations and joint directorates, together termed *FINANCE CAPITAL*). These bank-industry combinations worked with market-sharing agreements (*CARTELS*) and operated from behind high *TARIFFS*, whereas liberal economic principles were still largely upheld in Britain.

Apart from these sometimes contradictory sources, Lenin's argument is highly original. It is a typical product of his single-minded concern with the prospects for proletarian revolution (hence the incessant attack on Kautsky's 'ultra-imperialism' thesis). At the same time, he equally typically recognizes the new, in a sense unique, circumstances shaped by imperialist rivalry and war, which rule out dogmatic recipes for revolution. The analysis builds on the rise in importance of the banks as financiers of heavy industry, the turn to monopoly and the growing importance of foreign portfolio investments (*EXPORT OF CAPITAL* becoming more important than the export of commodities). Imperialism allows the bribery of the most privileged segments of the metropolitan working classes via the trade union and Social Democratic Party bureaucrats: 'the labour lieutenants of the capitalist class' (Lenin, 1960 70: vol. 22, p. 194).

The imperialist stage of capitalist development implies the most elaborate forms of 'socialization' of capital, not only in actual monopoly, but also as planned division of labour and application of science in production and centralized bookkeeping of entire economies by the big banks. But these forms of socialization can no longer remain coincident with national states. Capitalist control is private and hence only tentatively linked to particular states. Moreover, there exists a basically unstable relation between the alliances of capitalists and the states where they are headquartered. Capital develops un-

planned, unequally and irregularly (see *UNEVEN DEVELOPMENT*). But colonies and spheres of influence demarcated by states increasingly become immutably fixed, as the division of the globe between the most powerful states nears its completion. What if capital accumulates more rapidly in Germany (as it did after unification in 1871) and produces a powerful heavy industry, but colonies and spheres of influence are already controlled by earlier imperialist powers (such as Britain and France) in which capital accumulates at a lower rate?

Lenin's analysis thus can be summed up in four steps: (1) capitalist economic development proceeds *unequally*; (2) the division of the world has been *completed*, there are no virgin lands not yet occupied formally or informally by one of the major imperialist states; (3) economic development as a result demands *redistribution* of existing empires and spheres of influence; (4) in imperialism there is only one instrument for such redistribution: *WAR*. Such a war would expose the weakest among the imperialist states to a properly organized revolutionary proletariat. A Russian revolution in this light would have international consequences. It was bound to ignite a transformation towards socialism in the more advanced countries. The victorious forces from these countries would then assist the proletariat in the less-developed ones to construct socialism. But revolution in Russia was also certain to entail a revolt of the nationalities. This constitutes a second question Lenin dealt with in detail.

National self-determination

Marx's writings on the question of nationality had been written in the spirit of internationalism (the subordination of national questions to the international cause of the workers' revolution). Both he and Friedrich Engels were preoccupied with the creation of big, unified states. They favoured the national-democratic unification of countries such as Germany and Italy; of the oppressed nationalities, only those which (like the Poles and the Hungarians) had

played prominent roles in the 1848 revolution, would be entitled to their own states. Engels tended to particularly denigrate those small nationalities which he and Marx deemed not capable of ever reaching independent statehood – such as the Czechs or, for that matter, the Jews. Here Engels followed Hegel's qualification of 'nations without history'.

As the twentieth century drew closer, socialists became more sensitive to the aspirations of oppressed nationalities in Europe. Eastern Europe, after the defeat of Napoleon, had been divided up between three vast empires – Russia, Austria and the Ottoman Empire – each held together by a particular dynasty and religion, but otherwise hardly constituting real social units. With the growth of market relations, bureaucratic reforms and the first stirrings of an industrial revolution, the relations between subjects and rulers (as well as between the empires themselves) started to come apart. Urbanization and education exacerbated hitherto latent language issues and gave rise to the demand for national self-determination, often tinged with Romantic overtones and sometimes even imbricated with feudal particularism.

The right to national self-determination had been included in the founding programme of the Second International in 1896. The first author of the second generation to address the issue was Kautsky. He defined a nation by two criteria – territory and language. Henceforth, three positions on the issue crystallized: (1) the straight rejection of the right to national self-determination as a positive contribution to revolution (ROSA LUXEMBURG); (2) the recognition of a right to cultural autonomy (Austro-Marxism), and (3) the recognition of a right to political secession as a precondition for revolutionary reunification (the Bolshevik position).

The cultural autonomy position was worked out by the Austro-Marxists, Otto Bauer and Karl Renner. Bauer rejected the notion of 'unhistorical nations', but also did not want to sacrifice the unity of the Dual Monarchy deemed necessary for socialist construction. Therefore, nationality should be recognized as a cultural phenomenon. In Renner's view,

nationalities in a future socialist state should be organized in separate national councils irrespective of territory, and enjoy autonomy in matters of education and culture generally.

In the Russian Empire, some socialists entirely rejected the right to national self-determination (Rosa Luxemburg, Karl Radek and others). But the majority accepted national self-determination in principle. At the founding congress of the Russian Social Democratic Workers' Party in 1898, the *Bund* (an organization of Jewish craft workers) was admitted with autonomy in questions concerning the Jewish proletariat. At the Second Party Congress in 1903, the draft programme included the right of secession. However, when (towards 1912) Trotsky rallied a broad coalition of Mensheviks and nationalities behind the idea of cultural autonomy, Lenin instructed one of the specialists on the issue – the Georgian and future dictator, J.V. Stalin – to smash this idea once and for all. Stalin's *Marxism and the National Question* (1913), which was practically dictated by Lenin, added two criteria – a common history and economy – to Kautsky's original definition of a nation. It condemned the Austro-Marxists' ideas as unhistorical because they eternalized national differences. It did concede, however, that if a nation lacked a territory of its own, it still could be recognized as a 'nationality'.

Lenin himself put his ideas on paper in several writings: the best-known being *The Right of Nations to Self-Determination* (1914) (ibid.: vol. 20), which was directed against Rosa Luxemburg's rejection of this right. Lenin instead proposed to distinguish the era of bourgeois-democratic revolutions (which involve the mobilization of the peasantry behind the demand for political freedom and national rights) from the modern era (in which the class antagonism between international capital and the international labour movement occupies centre stage). As to Russia – which like Persia, Turkey, China and the Balkan states had entered the era of bourgeois revolutions only after 1905 – a socialist programme would have to support the right to national self-determination in its most radical form – that is,

by supporting the right to establish a separate state. Not only to prevent the bourgeoisie (the natural champion of the national cause) from subordinating the revolution to its own goals, but also because the proletariat had no choice in this question. For if it would reject national self-determination so as not to support the national bourgeoisie (Luxemburg's argument for Poland), it would by default support the chauvinist oppressors – in this case, the Russians. At any rate, on what grounds could one expect an oppressed nationality to side with the former oppressor-nation in a socialist revolution – by denying it the right to independence, or by granting it its own language, administration and state, and then reunifying as equals?

Lenin's programme, therefore, was composed of three elements: (1) the workers must resist the pressure of nationalism – the Russian proletariat should fight on the side of the proletariat of the oppressed nations; (2) the right to self-determination was to include the right of separation and constitution of a separate state; (3) at the same time, in the interest of the struggle against national isolation, the most energetic struggle was to be waged for unifying the different proletarian organizations.

The weak link in this programme consisted in the confidence that once the revolution was a fact, the proletariat – liberated from national oppression – would want to reunify with the former oppressor-nation. Indeed, when the international revolution failed to materialize, the right to secession had to be reconsidered. Even apart from chauvinist reflexes persisting among Great-Russian Bolsheviks and, paradoxically, among those (such as Stalin) who were themselves of a minority background, the civil war and foreign intervention ruled out a liberal attitude on this issue. Thus, in 1921 Menshevik Georgia was forcibly reincorporated by Bolshevik troops. Lenin resisted Great-Russian chauvinism and the autocratic impulses of Stalin in these matters for as long as he could, although the eventual practice of the USSR (and of Yugoslavia) would, surpris-

ingly, combine political centralization with cultural autonomy.

Lenin's expectation of the impending world revolution was not fulfilled. In the closing period of his life, he grew increasingly pessimistic about the short-term prospects for Soviet power, although he continued to place his hopes in the imperialist rivalries preventing the capitalist states from unifying against the USSR. In his last work, *Better Fewer, but Better* (ibid.: vol. 33), Lenin argued that the war had awakened the big countries of the East from their slumber and had drawn them into the maelstrom of world revolution. In the end, the global struggle would be decided by the fact that Russia, India, China and so on, accounted for the overwhelming majority of the population of the globe. Whether the USSR would hold out long enough to allow this majority to be mobilized against imperialism, depended on its capacity to raise the level of civilization of these countries and of the Soviet Union itself (which, in Lenin's view, was still insufficient to realize socialism).

Although his original analysis of imperialism continued to be developed by later Marxist thinkers, among other things to explain INTEGRATION as a means of redistribution without war, Lenin's own final conclusions seemed to point to a synthesis between his theses on imperialism and national self-determination. In this synthesis, the fate of socialism is linked to raising the level of development of the USSR (see SOCIALISM IN ONE COUNTRY) and to the struggles for national independence in what, at a later stage, would be called the THIRD WORLD.

See also:

Marxism- Leninism

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KEES VAN DER PIJL

Leontief paradox

The Leontief paradox arises from an attempt by the economist Wassily Leontief to test the standard HECKSCHER–OHLIN–SAMUELSON (HOS) MODEL OF TRADE (Leontief, 1953). That model implies that countries richly endowed with particular factors of production will gain COMPARATIVE ADVANTAGE by preferentially producing and exporting commodities whose inputs are relatively highly intensive in those factors. This result is fundamental to many arguments for FREE TRADE and the gains to be made from it, including the notion of the tendency for equalization of returns to factors of production.

Specifically, Leontief compared the capital/labour ratio of a representative bundle of US exports with that of a bundle of US-produced goods which competed with US imports (the data for actual imports were not available). The ratios used included, through the use of an input/output matrix, inter-industry flows of products embodying indirect capital and labour inputs.

Standard trade theory would assert that, as a relatively capital-rich and labour-scarce country, the US would export goods with higher capital/labour ratios than its imported (or import-competing) goods. However, Leontief found that representative exports had lower

less-developed country (LDC) debt management

capital/labour ratios than import substitutes, in the ratio of about 7:9. This is the Leontief paradox. Similar tests over other time-periods and for other countries have frequently produced similarly perverse results, although others have claimed that it is the result of misspecification (Leamer, 1980).

Several explanations of these results have been put forward. For example, the United States may use different technologies to those of overseas producers – specifically, higher capital/labour ratios in its own production of import-substituting products. It seems very reasonable to assume that a developed country will often use highly automated techniques to produce close substitutes for ‘handmade’ goods produced in poorer countries. Furthermore, the use of a two-factor model is a considerable simplification. In particular, the labour force is hardly homogeneous across the world: a much higher proportion of the working population in developed countries are highly educated and more productive, and many possess specialist SKILLS. On this basis, the United States can be regarded as effectively more abundant in (skilled) labour resources than raw numbers suggest.

Increasing the complexity of the standard theory appears to offer at least a partial resolution of the paradox. But the paradox lends some force to other theories of international trade that have been developed. For example, under the PRODUCT-CYCLE MODEL hypothesis, soon after innovation (typically in an advanced country) a product requires rapid modifications and developments in production processes, requiring skilled inputs. Later, as it matures and becomes standardized, it is able to transfer its production to areas with cheap, unskilled labour. Hence the production techniques for the same product may differ between countries.

Whatever the merits of various ‘explanations’, the Leontief paradox constitutes an important critique of the simple two-factor Heckscher–Ohlin–Samuelson model.

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JOHN CLARK

LESS-DEVELOPED COUNTRIES (LDCS)

see developing countries; least-developed countries (LLDCs)

less-developed country (LDC) debt management

The DEBT CRISIS dominated the 1980s development agenda, but has been heard far less of since. Does this mean the crisis has gone away and, if so, how was this achieved? In fact, many DEVELOPING COUNTRIES still suffer a severe debt-burden. To the extent that the crisis *has* been resolved, this has been achieved in large part by the efforts of the debtors, supported by creditor country governments. The original creditors – that is, the commercial banks – have not incurred substantial losses.

Three questions may be asked about the debt crisis of the 1980s: (1) what crisis? (2) whose crisis? (3) how did it happen and what has been done about it? This entry is mostly concerned with the last of these, but debt management needs to be understood in the context of the question: ‘whose crisis?’

The total external debt of developing countries rose rapidly from the 1970s, as the break-up of the BRETTON WOODS SYSTEM in the early 1970s unleashed the growth of international financial markets. This fact does not, in itself, represent a crisis; the crisis exists if the debtors are unable to repay. This was indeed the case: the usual starting date for the crisis being August 1982 when Mexico was unable to meet its obligations as it had no reserves of FOREIGN EXCHANGE. From that date, the crisis is

indicated by the build-up of arrears during the remainder of the decade.

How, then, did the crisis come about? The two main explanations may be caricatured as either (1) irresponsible lending on the part of creditors, or (2) irresponsible borrowing on the part of debtors.

The first explanation stresses the growth of international lending in the 1970s, fuelled by the two oil price booms. Following the theory of SOVEREIGN RISK (that is, countries cannot go bankrupt), lenders did not ask who was borrowing or what they would do with the money, so long as there was a government guarantee. This story can be supplemented with another that lays some blame at the door of the governments of developed countries. Commercial banks create money by re-lending deposits. Within each country, the extent of money-creation is controlled by reserve requirements, but these requirements are far less stringent at the international level and, where they were (for example, for UK-based institutions), banks successfully lobbied for them to be relaxed – this has been described as a ‘competition in fiscal laxity’. Meanwhile, the debtor countries were indulging in Ponzi finance (borrowing to repay). It was the combination of lax international reserve requirements with Ponzi finance, that allowed debt to escalate in such a rapid and unsustainable manner.

The second explanation stresses demand rather than supply: countries did not have to borrow or, having done so, countries could have invested the resources productively so they would be in a position to repay. Stories abound of the waste of borrowed resources: the personal wealth of Mobutu, the former president of Zaire, is said to equal the country's external debt. In fact, investment rates rose in the late 1970s, suggesting that some of the inflows were used to increase productive capacity, but the productivity of these investments frequently appears to have been low. A full explanation of the crisis needs to draw on both supply and demand factors.

The debt crisis potentially had adverse implications for developed and developing

countries alike. In the case of developing countries, more foreign exchange had to be used for debt service, thus tightening the already tight foreign exchange constraint and, since the vast majority of the debt was public or publicly guaranteed, debt service claimed a growing share of public expenditure (perhaps requiring greater tax collection). In addition, proponents of the notion of ‘debt overhang’ argue that a large debt-burden discourages private investment. Some Western commercial banks were very highly exposed to a small number of countries (as an extreme example, Manufacturers Hanovers’ exposure to five Latin American countries was 263 per cent of the bank’s capital) and so faced a very real possibility of collapse should a major debtor default. The potential collapse of one or more financial institutions was rightly seen as a large problem by Western governments, who were concerned about the economic repercussions of the consequent financial crisis. In the event, severe adverse consequences were avoided by the developed countries, but not by the developing ones. Hence, in some sense, developing countries may be said to have borne the burden of resolving the crisis.

There were three possible solutions to the debt crisis: (1) default, (2) restructuring and (3) forgiveness. In broad terms, the first of these has not been done: restructuring was used during the 1980s, at which time most Latin American countries eliminated their arrears, and forgiveness has become increasingly common in the 1990s for low-income countries, mainly in Africa.

For the government of a developing country that is experiencing difficulty in meeting its payment obligations, default may seem an obvious solution. In addition, there is legal precedent for default in the ‘doctrine of odious debt’ (applied by the United States when it took control of Cuba at the end of the nineteenth century), by which a government can repudiate debt incurred by a previous regime if the funds were not used for the benefit of the country’s citizens (the case already mentioned of Mobutu’s Zaire being an obvious example; the Philippines under Marcos is

another possible candidate). But while the benefits of default – not having to pay debt service – are readily apparent, the costs are far less certain. Three main costs may be expected: (1) no new inflows from either private or official sources in the short to medium term; (2) possible seizure of overseas assets (for example, foreign reserves held in the central banks of developed countries), and (3) possible trade sanctions from main creditor nations. The fact that debtors have not defaulted has been the result of the carrots (continued finance for countries undertaking to meet their obligations) and threatened sticks on the part of creditor countries. Specifically, to avoid crisis, creditor country governments needed to ensure an adequate flow of funds to debtor countries to meet existing (but rescheduled) obligations, preferably with a little ‘new money’ on top (‘new money’ means a gross inflow in excess of current debt service obligations). These flows were secured through a combination of official flows and involuntary lending by commercial banks.

The international response to the debt crisis may be divided into three phases: (1) 1982–5: austerity; (2) 1985–8: adjustment with growth under the BAKER PLAN, and (3) 1989 onwards: debt reduction under the BRADY PLAN and later initiatives.

A prototype for the initial response was presented by the package provided to Mexico, which comprised three elements: (1) \$2 billion from the US government (equally divided between advance oil purchases and money from the Department of Agriculture’s Commodity Credit Corporation) and \$1.85 billion from Western (and Japanese) central banks; (2) rescheduling by commercial creditors and \$5 billion of new loans, and (3) an agreement with the INTERNATIONAL MONETARY FUND (IMF) to an austerity programme that included cutting the public sector deficit from 17 per cent of GROSS NATIONAL PRODUCT (GNP) to 8.5 per cent. The participation of the commercial banks was involuntary in the sense that the IMF told the banks they would not sign the agreement with the Mexican government unless all banks agreed to lend 7 per cent of their

exposure (giving the required \$5 billion). The banks did this, but charged rescheduling fees and raised the interest rate so that the present value of debt (the discounted value of future debt-service obligations) rose rather than fell. Other agreements followed a similar pattern, but it became clear that the crisis would not be resolved in this manner.

A debtor may be facing either a liquidity constraint (cannot pay at the moment) or insolvency (unlikely to ever be able to repay in full). In the case of the former, then either rescheduling or additional inflows will see countries through their difficulties and it is in the creditors’ interest to facilitate this process (that is, the creditors’ as a whole – there is a FREE RIDER PROBLEM, dealt with by the involuntary lending agreements described above). The approach just described assumed countries were suffering liquidity problems, rather than being insolvent, and it may well have been expedient to present this image to prevent financial panic. But even if countries were not insolvent (which some undoubtedly were already), the austerity approach meant they may well become so: both imports and investment dropped sharply, thus threatening future growth (and of course development). The austerity approach was thus a mixed success: it did prevent the collapse of Western financial institutions, but at the cost of halting development in debtor countries and without eliminating the underlying debt problem.

In response to the shortcomings of the austerity approach, the US Secretary of State launched the Baker initiative of adjustment with growth, which promised even larger inflows to help restore growth. However, these inflows were not forthcoming, with both private lenders and official sources falling short of the targets for new lending (of \$20 billion each) to the most indebted countries, and it was clear that voluntary private lending was not resuming as expected. Hence economic performance did not improve in debtor countries, a fact which started to put pressure on the US government to find alternative solutions. In addition to any humanitarian considerations, there was a perceived threat to democracy

(seemingly confirmed by the Caracas riots in 1989 during which hundreds lost their lives) and US exporters complained of lost markets as Latin American imports collapsed.

The final period of international debt-management was ushered in by the Brady Plan, launched in March 1989. The plan gave official sanction to, and provided WORLD BANK and IMF funds for, the newly emerging debt buy-back schemes (notably that of Bolivia in 1988), under which debtor governments bought back their own debt at secondary market prices. Specifically, banks would be offered a menu of market-based options for debt reduction. In addition to debt buy-backs, there were a range of swaps and exit bonds. Under a swap arrangement, the bank sells the debt at a discount to another party, who then swaps the debt with the debtor government for an asset or activity denominated in local currency – usually the swap has been for equity (see DEBT-EQUITY SWAPS), but there have also been largely NGO-funded debt-for-nature and debt-for-development swaps, and the United Nations Children's Fund (UNICEF) have financed debt-for-child-development swaps. The market-based menu system has continued under a variety of initiatives, such as the Toronto Terms and the Naples Terms. The commercial banks were by now ready to accept debt reduction for two reasons. First, the containment of the debt crisis had given them an opportunity to make provisions for bad debts and diversify their lending portfolios. ('Provisioning' means that the value of bad debts is 'set aside', thus reducing bank profits and, thereby, dividend payments and tax bills; it does not mean that the debt is written off.) Second, by this time, with rescheduling fees and the higher interest rates having been charged, many banks had in fact got a good return on the monies they had originally lent and could now readily afford to reduce their exposure.

Official debt had been dealt with through the same combination of refinancing, rescheduling and reduction. Most bilateral donors have written off aid loans and many have also reduced debt on flows that are not Official

Development Assistance (ODA) (such as export credits and military assistance), thus creating 'unintentional past aid' (and leading to a debate in Development Assistance Committee (DAC) as to whether debt forgiveness of non-ODA flows can count as ODA, which it was finally decided it cannot). The World Bank and IMF represent a rather special case, as their Articles of Agreement prevent them from rescheduling their debt. They have got round this problem in two ways. The first has been to ensure sufficient aid inflows to avoid the necessity of rescheduling; there have been various frameworks for this, notably the Special Programme of Assistance for Africa (SPA) and the HIGHLY INDEBTED POOR COUNTRY (HIPC) INITIATIVE. This practice has been most transparent in the Fifth Dimension, an operation by which bilateral donors pay the multilateral debt-service obligations of low-income recipient countries, though the World Bank has also contributed from reflows from the International Development Association (IDA) – that is, repayment of IDA credits. (The Sixth Dimension is a World Bank-managed and bilateral-funded facility for buying back the private debt of low-income countries.) The second mechanism for avoiding rescheduling has been through IMF Rights Accumulation Programmes (RAPs), which also tackle the problem that countries in arrears to the IMF cannot have an IMF programme, which precludes World Bank and much bilateral assistance. Under an RAP, a country agrees to adhere to an IMF programme and thereby accumulates the right to borrow the funds it could have borrowed were it not for the country's IMF arrears. After two or three years, these accumulated rights will equal the outstanding arrears. At this point, bilateral donors provide a bridging loan to the government which hands the money to the IMF, thus clearing the arrears and enabling the IMF to release the accumulated rights as a new IMF loan. The government hands this money back to the donors. The net result is that the government owes the same amount to the IMF, but as a current loan rather than arrears, so the loan has effectively been rescheduled,

although technically there has been no violation of the IMF's articles.

An assessment of debt management must recognize that the strategy has been different for different countries. The main distinction to be made is that the middle-income debtors to a large extent paid back a large part of the debt and then carried out market-based debt reduction. The low-income countries, on the other hand, have serviced their debt entirely from new inflows and so have not borne the economic hardships that debt repayment imposed on the middle-income countries. The illustration of this point is that there were negative net transfers (net transfers being the difference between all funds flowing in and all funds flowing out) only for Latin America and the Caribbean from 1983–90, and for developing countries of Europe and Central Asia for 1985–9. All other regions continued to receive positive net transfers throughout the 1980s and 1990s.

An important aspect of the strategy has been the assumption of the debt burden by multilateral institutions: in 1980 the share of private creditors in total developing-country debt was 61 per cent; this figure had fallen to 53 per cent by 1990. For Latin America and the Caribbean, these figures are 76 and 62 per cent respectively, and for sub-Saharan Africa, 59 and 32 per cent. For the low-income countries in particular, these debt obligations are now being serviced by bilateral donors, so that Western taxpayers are paying the bill for debt that was partly originally contracted to private banks in the late 1970s and early 1980s.

The final point to note about the strategy is that debtors were always dealt with on a case-by-case basis through the PARIS CLUB for official creditors and the LONDON CLUB for private ones. In contrast to these creditors' CARTELS, debtors did not manage to form a debtors' cartel, which would have enabled debtors to collectively negotiate with individual creditors. This way of doing things clearly strengthened the bargaining position of the creditors vis-à-vis the debtors, one manifestation of which has been the ability of the creditors to require IMF stabilization and World Bank STRUCTURAL ADJUSTMENT PRO-

GRAMMES (SAPs) to be in place as a condition for debt agreements.

The role of the IMF and World Bank in the debt-management strategy is clearly controversial. Have their actions been motivated by a desire solely to ensure the maximum repayment of debt to themselves and Western creditors, or are their actions consistent with their roles as managers of the global economy and promoters of international development? It is quite easy to tell a story that seems consistent with the first answer. However, defenders of the IMF and World Bank would point out that default would have sparked off a chain of events, leading from financial crisis to global economic recession, that would have harmed developing and developed countries alike. Besides which, the need for debtors to agree terms for debt rescheduling provided the World Bank with an opportunity to obtain much needed economic reforms which are, they would argue, a precondition for sustained development.

See also:

conditionality; least-developed countries (LLDCs)

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HOWARD WHITE

letter of credit

A 'letter of credit' is a document committing a bank, on behalf of a buyer of goods or services, to make payment to the seller of those goods or services upon certain conditions (such as proof of delivery). Letters of credit are important in international trade since trust or reputation among exporters and importers may be difficult to establish at a distance. Jurisdictional disputes may arise if there is a failure to pay. There are many types, including (for instance) revolving (for ongoing purchases) or transferable (where the payment might go to the seller's supplier) letters of credit.

TONY PORTER

levels of analysis

The 'levels of analysis' refer to the different focal points for understanding why international events take place. The levels help analysts organize their enquiries and their theories about international relations (IR). The levels direct our attention to where we can find the basic causes of a state's foreign policy. Foreign policy is the outcome, or effect, that we are interested in explaining, while the different levels are the cause or causes of those policies. There are a number of different levels-of-analysis schemes. The most common classification has three levels: the individual or decision-maker level; the state level, and the international or systemic level.

The individual level of analysis refers to the characteristics – for example, psychology and personality – of given decision-makers which

affect their choices or actions. For example, the belief systems of any individual affect how they interpret information and their perceptions of situations, which in turn will affect the decision-making processes. RATIONALITY has also been identified as an important explanation for why decision-makers make specific policy choices.

The state or domestic level of analysis directs attention to the internal characteristics and workings of a state and how those factors influence the making of policy. For example, different forms of government may have an important impact on the kind of policy the state embarks upon. LIBERALISM posits that democratic states will be more likely than authoritarian states to embark on peaceful policies; public opinion and electoral accountability act as constraints on impetuous foreign policies. Other explanations for policy at this level might include bureaucratic processes and how those processes affect outcomes of policy, or how the economic systems of various states affect policy choices.

The international or systemic level of analysis focuses on the interactions of state and non-state actors. At this level, there is no examination of the internal characteristics of states or the individuals who run them. States are like units that act and react to compulsions in identical ways. This level contains theories which explore the consequences of states' relative positions of power within the system on the pattern of interactions among states and on the frequency of major power wars. Theories about the effects of POLARITY on the stability of the international system fit here.

Although the levels of analysis offer a device for organizing theories in the IR field, not all theories easily fit. For example, WORLD-SYSTEMS THEORY combines certain factors at both the second and the third levels, but does not really lend itself to classification. Other weaknesses of the levels have been pointed out by scholars who argue that the levels actually affect one another, making it difficult to distinguish causes emanating from any one level alone.

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PATRICIA A. WEITSMAN

LEVERAGING *see derivatives*

Lewis, W. Arthur (1915–91)

Arthur Lewis was one of the pioneers of development economics in the 1950s. He is best known for giving his name to the so-called 'Lewis model', a theory of growth constructed around the idea of 'unlimited supplies of labour'. Lewis argued that the central variable of economic development was capital accumulation. He assumed that there existed in all underdeveloped countries a dual economy, divided between a modern, fast-growing capitalist sector which used reproducible capital and a relatively stagnant, low-productivity traditional or subsistence agricultural sector which was not using reproducible capital (see DUAL ECONOMY, THEORY OF). For Lewis, economic development was in effect a function of the relationship between these two sectors over time. The expansion of the capitalist sector could proceed on the basis of drawing

in the infinitely elastic (or unlimited) supplies of labour that he saw as existing in the subsistence sector. Growth could thus continue until all this surplus labour had been absorbed, at which point the modern capitalist sector would dominate the economy and growth would become self-sustaining.

Lewis's theory fed directly into the world of development policy via his participation in key UNITED NATIONS (UN) studies of economic development in the early 1950s and his service as a UN adviser in West Africa. He was also directly involved in promoting policies of industrialization in his native Caribbean. Industrialization was needed to take surplus labour out of traditional agriculture; the region was short of capital, but labour was plentiful and wage-rates were low; the answer, in Lewis's view, was to persuade manufacturers already selling in overseas markets to locate their plants in the Caribbean. This required both detailed economic planning and active governmental initiatives (such as the provision of infrastructure, tariff protection and tax incentives) to attract external capital. The 'Lewis model' thus shifted the debate about economic development away from the doctrine of LAISSEZ-FAIRE and acknowledged a distinct role for the state in the pursuit of economic growth. It was undoubtedly a substantial influence on many governments in all parts of the developing world for a large part of the 1950s and 1960s.

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ANTHONY PAYNE

Lex Mercatoria

The *Lex Mercatoria* (literally, the 'law merchant') is the system of LAW that governed the commercial community in Europe in the Dark Ages. As the universal system of regulation of the Holy Roman Empire had dissolved and the consolidation of the laws of modern states had not yet taken place, the merchant community utilized a system of 'self-regulation' that was universally accepted. Texts that gave expression to such cosmopolitan principles included the Rolls of Oleron of the twelfth century (see OLERON, LAWS OF), the Consolado del Mare and the Maritime Code of Wisby, which governed the conduct of commerce in trading fairs and on the seas. The principles included such basic elements of contract as *pacta sunt servanda* (contracts should be enforced according to their terms), *abus de droit* (unfair or unconscionable contracts should not be enforced) and *rebus sic extantibus* (substantially changed circumstances can entail a revision of a contract), and also notably the practice of submitting commercial disputes to arbitration. For a time, the cosmopolitan rules of the commercial community took precedence over other forms of law: for instance, in England the Carta Mercatoria (1303) and the Statute of the Staples (1353) ensured the application of the *Lex Mercatoria* (instead of feudal law) in commercial disputes. The universal principles of the commercial community derived from the Roman 'natural law', which later was reserved for relations between *states* and not *individuals*. Over time, laws governing internationally oriented individuals were 'nationalized' and replaced by national systems of legislation as states consolidated their legal systems.

It is argued by some legal scholars (though they remain a minority) that the volume and complexity of international trade transactions that occurred particularly following World War II is not served optimally by the system of differentiated and compartmentalized legal jurisdictions of states. Private international law (the law governing commercial transactions among individuals across borders) is the practice of national courts determining which national law to apply to a cross-border contract (see LAW, INTERNATIONAL). This determination – made through the application of 'conflict of laws' rules – is concerned with finding the most appropriate national law to apply to a dispute, and this is the national law with the 'closest connection' to the contract. Given that many contracts can involve nationals of numerous states, it may not be possible to locate a clear centre of gravity in the contract (if one is not stipulated). Moreover, it may not be in the best interests of the contracting parties if the law with the closest connection to the contract is a national system of law that is relatively undeveloped (for instance, in major development contracts). Therefore, some scholars are arguing for the reintroduction of a cosmopolitan system of rules to govern the most highly integrated actors in international civil society: the transnational commercial community.

There are signs that the *Lex Mercatoria* is re-emerging. The IRAN-US CLAIMS TRIBUNAL – almost of necessity – has articulated principles for the governance of contracts that have their origin in neither Iranian nor US law, but which are derived from 'common practice' or 'generally recognized' rules of the international commercial community. Some states (such as Canada, France and the Netherlands) have amended their laws to accept the rulings of arbitral tribunals whose reasoning is based on the 'new' *Lex Mercatoria*. These are significant developments, for they could indicate that, for international commerce to operate effectively, its regulation must be freed from the control of states. It also could mean that 'generally recognized principles' derived from 'natural law' should not be confined to the relations between states, but could form part of the

liberal triumphalism

governance of the relations between individuals. International commerce could be entering 'post-modernity' by reverting to cosmopolitan roots that predate the Westphalian system of compartmentalization.

See also:

law, economic role of

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JARROD WIENER

LIBERAL INSTITUTIONALISM *see* institutionalism, liberal

LIBERAL INTERNATIONAL POLITICAL ECONOMY *see* embedded liberalism; institutionalism, liberal; liberalism; neo-classical economics; neo-liberalism

liberal triumphalism

'Liberal triumphalism' is a term introduced by ERIC HOBBSBAWM to denote the excessive exaltation over the (supposedly) final triumph of democratic CAPITALISM. For Hobsbawm, the period from 1975 to 1991 (and beyond) was the third and last period of a 'short' twentieth century (1914–91). He portrays it as the period of 'The Landslide', which is quite characteristic of his ideological ties. Hobsbawm, as well as many other intellectuals of the Left, are wary of liberal triumphalism, since they fear that an unrestricted capitalism, without a powerful ideological opponent, will be menacing.

However, and despite the appeal in some circles of theories such as the 'end of history' hypothesis of FRANCIS FUKUYAMA, the ensuing 'neo-liberal consensus' was more the result of the change in programmes and policy of the social democratic parties in Europe and North

America than of any sweeping liberal/conservative triumph. This neo-liberal consensus (also called the WASHINGTON CONSENSUS) was essentially the only tangible result of the 'liberal triumphalism' and was basically a set of economic policy-prescriptions imposed by the INTERNATIONAL MONETARY FUND (IMF) and the WORLD BANK on developing and developed markets, which was (sometimes) quite contradictory to the free-market ideas of the AUSTRIAN SCHOOL or even the CHICAGO SCHOOL of economics.

The liberal triumphalism climate underwent two defeats in the 1997–8 period, one real and the other bogus. The bogus one was the sweeping victories of social democratic parties in Europe, which led to *more* LIBERALIZATION, and the real one was the (probably) temporary defeat of the MULTILATERAL AGREEMENT ON INVESTMENT (MAI) that had been declared in 1995 by Renato Ruggiero – director-general of the WORLD TRADE ORGANIZATION (WTO) – as 'the constitution of a single global economy'.

See also:

free-trade imperialism; liberalism; new world order

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ARISTIDES N. HATZIS

liberalism

Many philosophers and movements have contributed to the theory of liberalism that has been so significant to the contemporary study

of international political economy (IPE). These include John Locke, with his seventeenth-century questioning of claims to political authority based on birth, social status, privilege and divine right, and the eighteenth-century physiocrats (or *les Economistes*) with their call '*laissez-faire, laissez-passer*', meaning 'let it be, let it pass' (see LAISSEZ-FAIRE).

The basic notion behind 'classical liberalism' is that government intervention should be kept to a minimum, emphasizing instead the role of the individual and the primacy of the mechanism of the free market. Three key ideas underlie liberal thought:

- 1 that there is great value to be derived from the free expression of the individual personality;
- 2 that such expression can be made valuable both to those who express it and to society, and
- 3 that institutions and policies that protect and foster both free expression and confidence in that freedom must be upheld.

The discussion that follows examines both liberalism's historical beginnings and its contemporary relevance.

In contrast to MERCANTILISM, with its strong role for the STATE, the roots of liberalism lie in the notion that governments can often be too intrusive in a state's economic activity. As a reaction to the prevailing mercantilist thought of the day, liberals argued for the inherent value of the individual and that individuals should be able to take part in economic activity free from the repression of the state. By doing this, liberals believe, a harmony of self-interest between individuals will be achieved. The key mechanism for any liberal is the market. Taking part in market activities is seen as a positive-sum game in which every participant gains. Such notions found their beginning in the work of ADAM SMITH (1723-90) and his theory of the INVISIBLE HAND. Smith held that society was such that, although individuals did indeed take action that would secure them advantage, the greatest benefit to society as a whole would be

achieved by allowing them to do so – a principle that also, significantly, could be applied to the world economy. Thus, just as government agents cannot effectively manage the myriad economic interrelations of the national economy, so too states should not interfere in world markets.

The role of freedom is crucial to Adam Smith's hypothesis. He argued that markets should be allowed to function freely, based on an appropriate DIVISION OF LABOUR. Doing this will ultimately ensure that EFFICIENCY and prosperity are maximized. Although Smith realized that vested interests, especially merchants, benefit from protectionism and will fight to retain the advantages derived from such policies, he argued that these specific interests should not be confused with the broader national interest, which is better served by the prosperity flowing from FREE TRADE.

Contrary to popular belief, however, Smith does not call for unilateral and unconditional free trade, offering four qualifications to his argument:

- 1 Free trade may be limited by the needs of national security.
- 2 DUTIES should be imposed on foreign goods equal to domestic taxes on national products, in order to avoid offering unfair advantage to imports.
- 3 Duties can be imposed as retaliation for unfair restrictions in foreign markets, but only as a means of forcing other states to rescind their duties. Retaliation in and of itself does more harm than good.
- 4 Free trade should be phased in gradually, so that domestic industry and labour have time to make the adjustments necessary to deal with the heightened levels of international competition.

Smith thus tempers his argument with an understanding both of the mercantilist practices prevailing at that time and of domestic political realities.

DAVID RICARDO (1772-1823) who in particular extended Smith's analysis of INTERNATIONAL TRADE, subsequently developed

Smith's ideas. For Adam Smith, the gains to be made from foreign trade were largely based on **ABSOLUTE ADVANTAGE**. Under such circumstances – when each nation can produce some specific commodity more efficiently than can any other – free trade is entirely beneficial. Ricardo, on the other hand, argued that even if a country did not possess an absolute advantage in the production of a particular commodity, they could still derive gains from foreign trade, if that trade was based instead on comparative costs. Thus, to gain the most from foreign trade, nations should concentrate on the notion of **COMPARATIVE ADVANTAGE**. The latter has become one of the major identifying concepts in the liberal analysis of trade. In this view, trade is not based on who can produce the most of any given good (absolute advantage) because limitations of scarce resources mean that no nation can produce as much as it wants of all goods and services. In this case, the value of the best alternative when a choice is made (that is, the opportunity cost) should be considered. The theory of comparative advantage holds that a nation should produce those goods that have a lower opportunity cost than the same goods produced in other countries. A nation should then import goods if the price of the import is less than the opportunity cost of home production (the **TERMS OF TRADE**).

Ricardo also revises the methodological ground of Smith's liberalism, separating economic questions from political ones. Although Smith's insights into the way in which free markets work do place individual economic actors in the middle of his analysis, Ricardo lays the foundation for the methodological individualism that is a hallmark of liberal IPE (see **INDIVIDUALISM, METHODOLOGICAL**).

Both Smith and Ricardo also draw out the implications of comparative advantage and free trade. As market mechanisms are carried from the national economy to the world economy, a certain equilibrium will be established in international economic relations. Indeed, a freely functioning international market should be self-correcting. Additionally, if all countries specialize and trade, then economic prosperity

is diffused throughout the world. Any country will therefore find a niche and benefit if liberal principles are conscientiously followed. International equilibrium and growth should arise from comparative advantage and free trade.

The economic focus of Smith and Ricardo's arguments raises the issue of whether liberalism is really a theory of IPE, given that it appears to subordinate politics to the point of non-existence. Closer inspection does suggest, however, that liberalism does embrace a theory of politics. It views politics as the rational management of a naturally harmonious community. This shapes the liberal notion of war and **INTERNATIONAL RELATIONS (IR)**. Nineteenth-century liberals, for example, argued that war is 'the natural state of men ignorant of the laws of political economy'. In other words, if free trade were encouraged, the likelihood of political conflict and war would diminish. Because war undermines productive capacity and saps national wealth and power, peace is logically in the interests of every state. Nineteenth-century liberals considered war to be a ruinous enterprise for all participants, due to its direct losses (such as the destruction of **CAPITAL** and the reduction of international trade) as well as to its opportunity costs (such as its effects on civil production). They also objected to armed peace because armaments, with their consequences of increased taxation and an ever-growing public debt, would also harm national welfare. In liberal opinion, peace should therefore be secured not through militarism but by free trade. Free trade increases national wealth and international communication, thus leading to the peaceful cooperation of nations within the framework of enlightened patriotism.

Given that the individual's interests are not hampered by a monarch's ambitions or by very small cliques of nobility or industry expecting gains from warfare, the invisible hand of the free-market economy will lead to international peace and prosperity, just like it would do within a nation's boundaries. For liberals, then, war is not an outgrowth of conflicting national interests, but arises from 'national interests ill

understood'. Political economy is thus the science *par excellence* of peace.

Such notions find favour too in the economic pacifism that was so prevalent before 1914. Its principal arguments aimed at the potential costs of war and the actual costs of armaments being too high for military options to be a rational means for pursuing national interests. Even if militarily victorious, a state cannot increase its wealth by the acquisition of new territories or by weakening the enemy's commerce and industry because the newly gained subjects are still competing with the victor and can now take advantage of a beneficial trading relationship. Moreover, any destruction of the opponent's property decreases the value of what has been conquered and eliminates an important potential customer for the victor. The loser can even gain some advantage from having to pay reparations: massive inflows of money to the winning country's economy may increase price levels there and lead to improved export chances for the vanquished.

In addition, for economic pacifists, war would also lead to a loosening of the monetary discipline of governments and parliaments, and to a total breakdown of international finance and investment. This confronts even the winner with the danger of bankruptcy. Finally, the economic net outcome of war has to be negative for all sides because of the fact that modern military technology leads to the mass slaughter of armies. Not only is war always bad for business, but the same is true for armaments – even if they are purely defensive. On one hand, the arms build-up results in an immense increase in public debt and consequently in higher taxes and INTEREST RATES, crowding out civil investment and preventing expenditure for social purposes. On the other hand, massive investment in naval power does not pay because military means cannot help to promote trade and commerce in the world market. Thus, if a country's economic wealth is not only independent of an increase in its military capacity but even hampered by it, the logical consequence must be the historical

necessity of disarmament and the end of war as a political and economic instrument.

Although the ideas of economic pacifism are extreme, they do fall in with the liberal notion that it is economic stability that brings peace and prosperity, rather than the build-up of arms. Such ideas can be seen in more recent times, with the creation of the liberal post-war trading structure. At the end of World War II, policy-makers very much felt that the GREAT DEPRESSION of the inter-war years was an example of serious flaws in the market, especially during periods of RISK, uncertainty and ignorance. One of the major architects of this post-war strategy of free trade was JOHN MAYNARD KEYNES, who continued the evolution of liberalism with ideas favouring state action to shore up market failures coupled with an activist macro-economic policy. The thrust of his complex and controversial argument was aimed at the liberal belief that markets inherently tend towards a socially beneficial equilibrium. Instead, he contends that production and consumption more often than not reach a balance with unemployment still at a relatively high level. Keynes' response to this problem breaks with liberal precedent. He advocates intervention in the economy in order to stimulate both employment and investment. Although such action, in Keynes' mind, should be countercyclical and complementary to market forces, this point challenges the basic liberal argument that economic prosperity can best be gained without state management.

Generally, Keynes argues that a country must have full employment as its primary economic goal to avoid debilitating and unnecessary recessions. This priority both influences and is influenced by international economic policies. To secure full employment, for example, a country will want to run a balance of trade surplus. By the same logic, every country will want a trade surplus. This implies that protectionism may follow from domestic Keynesian policies. Although Keynes exhibits a nationalistic streak, he was not a protectionist. He understood that the devastating BEGGAR-THY-NEIGHBOUR POLICIES of the inter-war years must be avoided. This is best

accomplished through international economic cooperation: he supported efforts to create international institutions to provide national leaders with some flexibility in balancing domestic priorities with international obligations.

Keynes shifts the debate in liberal IPE away from the issue of whether international intervention should occur, to what sort of institutions should be created. The key is his basic acceptance of economic management and consequently a role for the state at the international level. As with his domestic interventionist ideas, such management should complement not contradict underlying world market forces. Keynes thus stays within the purview of liberal thought.

However, by bringing the state into his analysis, Keynes poses new problems for liberalism. The issue of how states should intervene internationally eventually leads to the question of why states actually intervene as they do. A series of events in the late 1960s and early 1970s raised this issue. The BRETTON WOODS SYSTEM disintegrated, calling into question liberal arguments regarding international cooperation. In addition, many LESS-DEVELOPED COUNTRIES (LDCs) were not gaining the benefits of comparative advantage, challenging liberalism's predicted international diffusion of economic development. These events suggested that markets behave differently than liberal theory holds; in a word, they appear to be politicized. Increasingly, the theoretical progress of liberalism can be gauged by how well its assumptions explain the political dynamics of international markets.

An important part of IPE that embraces some of the notions of liberalism is that of INTERDEPENDENCE. In their landmark work on interdependence theory, ROBERT KEOHANE and Joseph Nye argued that economic changes do not negate politics, but create a new type of economics. Their conception of interdependence is a synthesis of IR REALISM and liberal IPE. While accepting the realist notion that military force can dominate economic relations, Keohane and Nye add the qualification that military power may be irrelevant to issues

other than direct threats to vital national interests.

In particular, Keynes participated in the birth of the Bretton Woods system, which sought to create a liberal system of international economic relations, but one that would allow individual nations to use state policy to support domestic markets and insulate them from DEPRESSIONS. This compromise between stronger market (internationally) and stronger state (domestically) roles is known as the Keynesian compromise of the system of EMBEDDED LIBERALISM.

Eventually, Keynesian liberalism evolved to include ever increasing amounts of state interference in the market and, as this happened, a backlash developed during the 1950s and 1960s that took the name 'conservatism'. Its *raison d'être* was the resurgence of the classical liberalism of Smith and Ricardo. The significance of this movement was seen during the 1980s when classical liberal thought grew in importance under the guise of 'neo-conservatism'. The policies of 'REAGANOMICS' and Thatcherism were indicative of this, with their emphasis on the PRIVATIZATION of STATE-OWNED ENTERPRISES (SOEs) and the DEREGULATION of markets. Liberalism today continues to embrace such notions with a focus on the benefits of individual action and the potential for the abuse of power, particularly that which resides in the hands of the state.

Indeed, the collapse of the COLD WAR divisions has signalled for some the triumph of liberalism over any other IR theory.

See also:

neo-liberalism; neo-mercantilism; world-systems theory

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ALISON M.S. WATSON

LIBERALISM, EMBEDDED *see* embedded liberalism

liberalization

'Liberalization', from an economic perspective, is generally viewed as a freeing of the marketplace from government interference and regulation. Conventional (neo-classical) economics argues that the pursuit of self-interest by consumers and producers via competitive markets results in the best for all (see NEO-CLASSICAL ECONOMICS). This is what ADAM SMITH called the operation of the INVISIBLE HAND. Markets work as if an invisible hand was guiding the activities of buyers and sellers so as to maximize benefits for the group. Government interference is, from this perspective, a hindrance to consumers and producers, thus reducing the benefits of market interaction.

Of course, the conventional view does not mean to imply that the government has no role to play. It must, of course, provide those kinds of goods and services that are difficult to provide via markets. These activities include provision of infrastructure and national defence. In addition, property rights must be identified and protected and laws governing what is acceptable and unacceptable behaviour in the marketplace must be developed and enforced.

Many scholars believe that government has often gone significantly beyond the functions listed in the previous paragraph. Liberalization represents a reduction of government influence

in the economy and perceives a minimal role for the state.

Role of the (minimalist) state

Micro-economic liberalization includes the following: PRIVATIZATION, LIBERALIZATION OF TRADE, PROPERTY RIGHTS enforcement and financial reform. In the developing nations and the once socialist states of Eastern Europe and the old Soviet Union, the state controlled a large segment of the economy via direct ownership. Many of these state-owned firms operated without competition and faced no real budget constraint. The latter implies that budget shortfalls for such firms were made up via subsidies from the state. Various efforts have been made to convert these into privately owned firms, open to competition both domestically and internationally.

Trade liberalization relates to the extent to which firms are provided with incentives to produce for the domestic market, relative to the foreign market. Many developing nations have imposed TARIFFS and QUOTAS on foreign-produced manufactured goods. Since this raises the domestic price for these goods, it raises the incentive to produce for the domestic market relative to the foreign market. Resources flow out of the production of exports, resulting in balance-of-trade and -payment difficulties (see BALANCE OF TRADE; BALANCE OF PAYMENTS). Trade liberalization involves eliminating tariffs and quotas in order to restore incentives for production for foreign markets.

Many nations, in particular developing nations, have interfered in financial markets so as to keep INTEREST RATES low. Unfortunately, this reduces savings and creates a shortage of funds available for INVESTMENT. Financial reform would involve raising interest rates and eliminating financial regulations. The latter would improve competition in the financial industry while the former would induce greater savings.

The structures of property rights are not very well developed throughout much of the world. The notion here being that if one cannot be assured that the returns from work-effort

liberalization of trade

can be protected from arbitrary confiscation, either by the state or private organizations, then there is little incentive for investment or innovation. Thus, the protection and reform of property rights is necessary.

At the macro-economic level, government mismanagement of the supply of money, the budget and the EXCHANGE RATE are seen to result in additional losses of efficiency. Rapid growth in the money supply, combined with budget deficits, tends to create rapid increases in price levels (INFLATION). Liberalization in these areas generally involves trying to reduce the degree of discretionary control the state has over the money supply and the budget. This often involves setting rules for the rate at which the money supply can grow and limits on the growth of spending. The ultimate goal here being to reduce government's influence at the macro-economic level.

An alternative perspective

Critics of the minimalist approach point to the fact that neo-classical economics tends to ignore the issue of POWER. Markets are effective means of allocating resources, but in environments where economic wealth and political power are unequally distributed, this will result in inefficiency for the few and poverty for the many. Thus, the state is seen as a possible mechanism for countering this inequality.

There are also problems of investment coordination at the macro level that would seem to indicate a significant role for the state. Investment activities by individual firms are often unprofitable if carried out in isolation, but if part of a coordinated programme of investment will not only be profitable, but also result in significant productivity growth. The state can be seen as providing indirect coordination of investment spending.

Related to the above problem is a more general sort of coordination problem. If markets are always in equilibrium, then sellers always find enough buyers and vice-versa. However, shocks to a market system often push buyers and sellers out of equilibrium. If prices do not quickly move to restore equi-

librium between buyer and seller, production and employment changes often do. The point here is that the lack of coordination across markets may generate situations of recession or depression. The state's function here would be to stimulate overall spending to restore full employment via tax cuts and spending increases.

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RICHARD GRABOWSKI

liberalization of trade

'Trade liberalization' is often recommended as appropriate policy, especially for developing nations. It usually involves the reduction or elimination of TARIFFS (taxes) and QUOTAS (quantity limitations) which have been levied against imports of foreign goods and services. Such tariffs or quotas protect domestic producers of the goods or services by reducing the degree of competition from foreign producers. Tariffs serve an additional function for many developing nations – the generation of revenue for the state.

Perhaps a more precise way to think about trade liberalization is to think in terms of incentives. Countries, especially developing countries, have often used tariffs and quotas to raise the incentive for domestic producers to produce for the domestic market. Of course, this implies that incentives for production for foreign markets will be reduced and resources will be reallocated away from production for foreign markets and towards production for the domestic market. Trade liberalization aims

at equalizing incentives by redressing this imbalance through reduction of the incentive to produce for the domestic market. The ultimate aim is to provide equal sets of incentives or a neutral incentive structure. This can be achieved by reducing or eliminating tariffs or quotas on imports, or providing subsidies for export production that offset the effects of the tariffs and quotas on the incentive structure.

There are three broad schools of thought concerning trade liberalization: neo-classical theory, DEPENDENCY THEORY and new trade theory. These will be discussed below in the context of developing nations.

Neo-classical theory

The gains from free trade follow from the pursuit of COMPARATIVE ADVANTAGE. Each nation specializes in the production of those goods that it is relatively good at producing (those for which it has a comparative advantage) and exports these goods. Alternatively, those goods in which a nation is relatively not so good at producing (comparative disadvantage) are imported. Thus, via specialization and trade, all nations can be made better off.

What determines which country will have a comparative advantage in which good? There are many answers to this question, but perhaps one of the most interesting is that provided by the factor proportions theory, also known as the Heckscher–Ohlin theory. The idea is quite simple. Assume that there are two inputs – labour and capital (machinery) – used to produce two outputs – a manufactured good and an agricultural good. In addition, assume that the manufactured good uses a lot of capital and little labour, while for the agricultural good the reverse holds. In this situation, a country where capital is abundant and cheap, but labour is scarce and expensive, will find it possible to produce the manufactured good relatively cheaply. Alternatively, a country where labour is abundant and cheap, but capital is scarce and expensive, will find it relatively cheap to produce the labour-intensive agricultural good.

The implication of the factor proportions theory is quite important. In the labour-abundant (say, less-developed) nation, the production of the labour-intensive agricultural good will expand, while the production of the capital-intensive manufactured good will contract. In this process, the wage rate of labour will rise, while the relative price of capital falls. Alternatively, in the capital-abundant (developed) nation, the production of the capital-intensive manufactured good will expand, while the production of the labour-intensive agricultural good will contract. In the process, the wage rate here will fall, while the relative price of capital rises. The end result is that wages and the price of capital tend to be equalized between nations engaged in trade. It follows, then, that free trade not only has the potential to benefit all nations, but it also tends to equalize the distribution of income across nations.

The implication of neo-classical trade theory is that free trade enhances welfare and promotes equity. However, if the reduction of tariffs and elimination of quotas are not possible (perhaps for political reasons), similar benefits can be achieved by subsidizing exports so as to achieve incentive neutrality between production for domestic and foreign markets.

Dependency theory

Theorists from the dependency school of thought come to quite different conclusions concerning free trade and trade liberalization. They tend to divide the world into an industrialized centre and a poor periphery (see CORE–PERIPHERY MODEL). The centre produces mainly manufactured goods, some of which are exported to the periphery; on the other hand, countries of the periphery produce mainly primary commodities, and agriculture- and mining-related products, most of which are exported to the centre. This pattern of trade is a result of the workings of comparative advantage via free trade.

Dependency theorists argue that rather than having a positive impact on living standards and equity, free trade tends to have strong

negative impacts on the countries in the periphery. There are a variety of mechanisms by which this can occur. A number of these mechanisms involve the **TERMS OF TRADE**. The simplest version of terms of trade is the price of exports divided by the price of imports. A number of dependency theorists argue that the terms of trade tend to deteriorate for the periphery. That is, the prices of the primary product exports of the periphery tend to fall relative to the price of the manufactured imports. This would certainly reduce the benefits of trade for the periphery and, if the terms of trade deteriorate enough, the standard of living in the periphery might actually be reduced.

Why do the terms of trade tend to deteriorate for the periphery? This is usually related to the fact that world demand for agricultural goods does not grow as rapidly as the world's income grows. In addition, technical innovation in the centre has often created close substitutes for the primary products of the periphery. This, combined with other factors, implies that increases in the supply of goods from the periphery (due to productivity increases there) are likely to lead to falling prices for primary products.

Alternatively, productivity increases in manufactured goods at the centre do not result in lower prices. This is often attributed to the **MARKET POWER** of large corporations and unions. This market power allows groups within the centre to keep the gains from productivity increases there, essentially by preventing the prices of manufactured goods from falling.

There are other mechanisms by which the centre inhibits the growth of the periphery. Investment in the periphery by firms from the centre is such a mechanism. Specifically, centre-owned firms operating in the periphery can transfer profits from the latter to the former. These profits, which could have been used for investment in the periphery, are used instead to raise the levels of consumption and investment in the centre.

Note that dependency theorists introduce a variable that has been generally ignored by

neo-classical theory: the inequality of **POWER** between centre and periphery is what allows the centre to turn the terms of trade in its favour and thereby extract profits from the periphery. Thus, the poverty of the periphery is not the result of the natural workings of the economic system. The solution to the poverty of the periphery is for this group of nations to decouple themselves from the world economy, limiting trade between the centre and periphery while increasing trade within the periphery.

Finally, one should note that this school of thought is often labelled neo-Marxist (see **NEO-MARXISM**). It is certainly not Marxist in the traditional sense of emphasizing the exploitation of labour by the capitalist class (see **MARXISM-LENINISM**). Instead, it emphasizes the exploitation of the periphery by the centre via class alliances between foreign and indigenous elites.

New trade theory

In terms of methodology, the new trade theory is firmly anchored in neo-classical economics. However, by incorporating a few changes in assumptions into their analysis, results similar to those described in the dependency school become possible. The distinguishing characteristic of the new trade theory concerns the assumption of increasing returns, as opposed to constant returns.

In neo-classical economics, the technological relationships involved in production are captured by the production function. The latter indicates, for a given technology, how much output can be produced for specific quantities of capital and labour. The key characteristic concerns returns to scale: that is, what happens to output if the scale of operations increases via a proportionally equal increase in both capital and labour. If output increases by the same proportion, say a 10 per cent increase in output for a 10 per cent increase in capital and labour, then constant returns prevail. This is what is assumed by neo-classical economics in the analysis of the impact of trade liberalization.

Much of the new trade theory introduces to the analysis the idea of increasing returns: that

is, if capital and labour in an economy are increased by 10 per cent, output rises by more than 10 per cent. Increasing returns can result from significant fixed costs, technological complementarities, benefits gained from technological learning and so on. If one assumes that manufacturing is subject to increasing returns to scale, while agriculture is characterized by constant returns to scale, then some interesting results emerge.

Assume a world made up of two countries. Both produce agricultural and manufactured goods, and transportation costs are too high for trade to occur. Suppose that one of these countries, North, for some reason has a larger manufacturing sector than the other, South. If transportation costs fall so that trade occurs, then North will be able to produce manufacturing goods more cheaply than South as the result of increasing returns. North will specialize in manufactured goods with rising productivity, while South will specialize in agricultural goods with stagnant productivity.

In this simple model, the world divides into a centre and periphery on the basis of the historical accident of which country happens to begin producing more manufactured goods. The driving force in the model is the increasing returns to manufacturing and the result is a periphery specializing in low productivity activities. The returns to inputs will rise in the centre (North) and remain stagnant in the periphery (South), with incomes across nations becoming increasingly unequal as a result of trade.

The implications of trade liberalization are much more ambiguous in this model. Increased trade via comparative advantage will indeed improve the standard of living in both countries in the short-run, via improvements in the allocation of resources. However, in the long-run, the rate of growth in the centre will exceed that in the periphery. Furthermore, as long as the periphery continues to export products characterized by constant returns to scale, productivity will remain stagnant.

Some scholars have used these ideas to argue that less-developed nations should create new comparative advantages, rather than allow

their economies to be driven by historically determined comparative advantage. This would initially involve the protection of certain select import-competing manufactured goods. This would allow the production of these goods to expand and, via increasing returns, become increasingly competitive. Then export-promotion policies would be used to stimulate production for foreign markets. Thus, initially incentives for domestic production of selected manufactured goods would be increased, followed by a shifting of incentives in favour of export production. In this way, comparative advantage in manufactured goods production could be created.

Unfortunately, most less-developed nations have remained stuck in the import-protection stage. Many of the industries have failed to achieve the hoped for increasing returns and thus rapid export growth has not been achieved. However, a number of countries in East Asia seem to have been successful in promoting rapid economic transformation. It seems that the difference in experience is related to the strength of the state and its ability to resist interest groups whose pursuit of self-interest often results in the sabotage of effective government policy.

See also:

infant-industry protection; neo-mercantilism; world-systems theory

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RICHARD GRABOWSKI

liberation theology

The term 'liberation theology' applies to the efforts of Christian theologians to articulate their faith in struggles against economic poverty, social injustice and political oppression. Of Latin American origin and dating from the 1960s, liberation theology can be seen as a type of critical theory that fuses spiritual and biblical themes with Marxist and neo-Marxist methodology (see MARXISM—LENINISM; NEO-MARXISM). It can be briefly summarized as a way of 'doing theology' that involves:

- 1 a theological critique of the capitalist means of production and the ideologies that sustain it;
- 2 a theoretical challenge to the Church's historic complicity with unjust social orders, and
- 3 a Christian empirical commitment to CLASS STRUGGLE and radical CHANGE.

When used in the singular and without further clarification, liberation theology normally applies to the Latin American movement connected with the names of Gustavo Gutiérrez, Juan Luis Segundo, Leonardo Boff, and other Catholic and Protestant theological writers of the 1960s and 1970s. It is, however, misleading to think of only *one* liberation theology. Liberation theologies in the plural refer to a range of practical theologies that deal with various and specific aspects of oppression. Consequently there are a number of liberation models including 'black', 'African', 'Asian' and 'feminist' (see FEMINISM).

The Latin American model for liberation is one associated with the failure of the development programmes of the 1950s and 1960s. For many Christians, the recognition of the UNDERDEVELOPMENT thesis, the rise of DEPENDENCY THEORY and the growth of a popular revolutionary consciousness demanded that the Church decide in whose interests it worked and spoke. Liberation theologians responded by proclaiming a univocal commitment to the poor, marginalized and powerless. As Gustavo

Gutiérrez insists, such a commitment 'offer[ed] not so much a new theme for reflection as a *new way to do theology*' (Gutiérrez, 1973: 6–15).

From Marx's reversal of the accepted relation between history and social reality, liberation theologians begin with the suspicion that interests are served by ideological constructs. All human knowledge, they argue, is gained from a particular perspective and is marked by an 'ideological taint'. Conceptions of God and 'other-worldly' affairs are therefore not apolitical, neutral or socially innocent. They are a system of ideas that can serve, and have served, secular interests. Christianity's traditional failure to recognize this has meant that theological discussions have usually operated in the interests of the status quo. This is because it is only in the interests of the status quo that ideas are not questioned, discussed and relativized. The point here is that the intellectual structures developed to define religious obligations are determined in varying ways by the social structures that people, and not God or nature, have created.

The failure to recognize the fabricated nature of intellectual structures both inhibits 'true' theological knowledge and continues Christian support for an unfree social order. The intention of liberation theology is thus to free religious discourse by pointing out where it stands in relation to the facts of social existence. Once Christians learn to grasp the facts of their intellectual dependence on historically oppressive and culturally specific socioeconomic structures, they are rendered free to decide whether or not to be *consciously* allied with existing power arrangements.

Central to liberation theology epistemology is the notion of praxis – the fusion of theory with practice. Theological analysis is seen as the precursor to political activity. In this way, liberation theology is both *theory-for-praxis* (a call for action in the form of criteria, methods and so forth) and *theory-of-praxis* (the 'second act' that follows the questions and insights that come from its practitioners' involvement with social movements). Praxis begins with the active quest for liberation and, through poli-

tical participation, is strengthened and clarified.

Liberation thinking is theologically profound because it amounts to a fundamental rejection of the enlightenment view that political commitment is a barrier to religious knowledge. It is politically significant because it demands a particular participation by Christians in social affairs. In short, liberation theology calls on Christians to decide whose side they are on in social struggles. Liberationists suggest, first, that Christians debate which resources, violent and non-violent, should be utilized to help create an authentic and liberated humanity. Second, they then encourage Christians to fight for the oppressed, to understand the roots of inequality, and battle for the transformation and humanization of social circumstances. Finally, they argue that there is a universal religious responsibility for engaging in class conflict.

Particular importance is attached by liberation theologians to the development of new types of basic or grass-roots Christian communities. Originally conceived as groups that would spearhead pastoral and educational effort among the masses, these CEBs (from the Spanish, *Comunidades Eclesiales de Base*) have come to be seen as a 'revolutionary vanguard' of a vaguely Leninist kind. The aim of these intellectual agencies is to raise political consciousness and open up possibilities for the mobilization of the masses. This minority does not seek sectarian ends, but rather leads by example: a radical, essentially political, yet reflective and sacramentally orientated Christian discipleship. Such communities live with the constant likelihood of defeat on the quantitative level, but aim to remain a symbol of hope pointing towards possible futures in an unjust present. The intention, as the theologians often put it, is to exist in a dialectical situation seeking to become the subject of one's own history.

It should be clear that these ideas lean heavily on Marx, neo-Marxist structuralist theory and Leninist theories of imperialism (see IMPERIALISM; STRUCTURALISM). Indeed, the liberation theologians' preference for eman-

cipation inevitably involves making choices for or against Marx. Because of its radical character, it has often been criticized by the Vatican and other conservative commentators as a theological heresy that is weak on God but strong on the ethics of socialist JUSTICE. Liberation theology counters, however, by arguing that anyone engaged in a serious analysis of society is at least part Marxist, since it was Marx who was responsible for the decisive change of direction in social understanding (Segundo, 1976: 25). It is Marx who the theologians credit with showing that the presuppositions of liberal political theory and of POLITICAL ECONOMY are culturally specific and structurally determined. Yet, because liberation theology is – rightly – seen as relativizing theological language, it has been blamed for undermining religious certainties. For the liberationist, however, such relativization is not a problem, because theologians should be sensitive to social context. What is important is how the theologian's reflection relates to context, or whose side it is on. In this sense, theological notions are in effect inseparable from a commitment to a particular human project, because spiritual truth is inseparable from social fact.

This does not mean, however, as European and North American critics constantly argue, that the liberation project means the politicization of the Christian Gospel or the identification of the Kingdom of God with a BOLSHEVIK utopia. A simplistic conflation of liberation theology with a particular type of Soviet-style Marxism should be avoided.

Two observations about its use of Marxist methodology might therefore be registered. On one hand, it is necessary to consider the extent to which Christians can actually evade the challenge posed by post-Marxist accounts of their relation to social reality and social conflict. On the other hand, it is necessary to appreciate that efforts to renew humanity and create a freer society are indelibly bound to Marxist-inspired political action.

In terms of its political application in the modern world, liberation theology should be considered less as a homogeneous movement

licensing

and more as a Christian methodological commitment to revolutionary change. In this way, it serves as a radical challenge to Western (theological) methodological individualism and the 'consensus' approach of traditional Christian social thinking (see INDIVIDUALISM, METHODOLOGICAL). As an approach, it is significant because it is not constructed from above via the delegation of power from the state or Church authorities. And because it rejects the unfettered freedom of the Christian individual to act without social responsibility.

See also:

Frank, Andre Gunder: historical materialism; Marx, Karl Heinrich; New Social Movements; race; Wallerstein, Immanuel; world-systems theory

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JONATHAN GORRY

licensing

A licensing agreement is an agreement between the owner of some body of technological knowledge (for example, a design for a new product, a new method of producing a good, a brand name or a trademark) and a potential user. In countries where industrial PROPERTY RIGHTS are recognized, any firm wishing to make use of the property of another firm must pay the owner for the right to use its intellectual property. Under the agreement, the licensee will undertake to pay the licensor either a lump sum or some percentage of the eventual sales or profits earned from the sale of goods or services which embody the technology in question. The agreement may also place controls on the use of the information acquired by the licensee (such as the geographical territory where the good may be sold, or the standard of quality or of after-sales service that must be maintained for the good). For developing countries wanting to acquire technology created by firms in the advanced industrialized countries, a licensing agreement is often preferred to reliance on capital INVESTMENT by the foreign firm. For MULTINATIONAL CORPORATIONS (MNCs), it may be the only way of gaining access to an overseas market, as when the overseas government prohibits the setting up of a foreign subsidiary and exports are subject to high TARIFF or NON-TARIFF BARRIERS (NTBs).

NIGEL GRIMWADE

limits to growth

'Limits to growth' theory shows how economies are prevented from continually increasing their throughput of materials and energy by the natural resource and environmental systems

within which they are embedded. The literature is a reaction against modern economic analysis that treats the economy as independent of both resources extracted from and wastes pumped back into the ENVIRONMENT.

Classical economists were aware of such limits. THOMAS MALTHUS emphasized the potential for POPULATION GROWTH to outstrip any expansion in food supplies, leading to periodic famine. JOHN STUART MILL wrote some often quoted passages about the potential for the degradation of natural and wild places, while Stanley Jevons was concerned that the industrial economy was dependent on an essential mineral (coal), which once depleted would lead the system to collapse. However, the ability of technological developments (for example, energy and chemical-intensive agriculture) to avoid these constraints and provide substitutes (for example, oil) led to greater optimism. Neo-classical economists emphasized the role of prices in signalling an approaching resource constraint and stimulating technology (see NEO-CLASSICAL ECONOMICS). Pessimistic scenarios were avoided and 'Malthusian' economics derided.

In 1972, Meadows, Meadows and Randers published a seminal book revitalizing the debate and building on popular ENVIRONMENTALISM. Five factors were emphasized as combining to cause a potentially dramatic collapse of the modern industrial economy: population growth, inadequate agricultural production, depletion of natural resources, accelerating industrialization and pollution. A simple model illustrated the difficulty of avoiding collapse, because controlling for one or two aspects of the problem might neglect or exacerbate the others. Exponential growth was a key factor. This resulted in relatively long periods without apparent problems, followed by a dramatic acceleration towards systems limits: for example, human population took 250 years to double (in the 1600s), but now will double in only around 35 years.

The study argued that within 100 years, given current trends in the five factors, limits would be reached causing a sudden and uncontrollable decline in industrial capacity.

However, growth trends could be altered to establish sustainable ecological and economic stability. Reliance on technology could be dangerous, leading to unknown physical and social side-effects, and requiring continual social change. Technology merely substitutes one limiting factor for another potentially worse one. Avoiding the limits to growth would mean accepting the constraints of natural systems and deriving human well-being from non-material aspects of life.

An often forgotten aspect of the resulting debate is the prospect of SOCIAL LIMITS TO GROWTH. Fred Hirsch (1977) addressed this directly. Meadows, Meadows and Randers also emphasized that the political question may arise long before the ultimate economic one – for example, the nationalization of mines and successful Middle Eastern pressures to raise oil prices. Despite the claims of some economists to the contrary, they also saw price rises as being the consequence of depletion rather than complete exhaustion.

Renewed environmental concern in the 1990s gathered around the notion of SUSTAINABLE DEVELOPMENT. Much of the rhetoric here shows the desire to justify 'business as usual'. Development is equated with material and energy consumption, rather than human well-being, while key works (such as those of the WORLD BANK or Brundtland Commission) have emphasized traditional ECONOMIC GROWTH as actually achieving environmental improvement rather than degradation. The term 'limits to growth' apparently proved too unambiguous.

See also:

ecological economics

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CLIVE L. SPASH

List, Friedrich (1789–1846)

Friedrich List, who has been described as ‘the apostle of economic nationalism’ (Viner, 1950: 94), was born in Reutlingen in 1789. List’s diverse and chequered career began with employment as a clerk and accountant in public administration, before he became a lobbyist for the creation of a German customs union. It was only when his trial and conviction for sedition led to exile in the United States in 1825 that List found an audience for his political economy of economic nationalism among Pennsylvanian industrialists and the wider readership of the weekly German language newspaper he edited. List’s prolific correspondence and economic journalism led to his first major publication, *Outlines of American Political Economy* (1827). List recognized Britain’s dominant naval and commercial power, but rejected the cosmopolitan and individualistic classical political economy developed by ADAM SMITH in *The Wealth of Nations* (1776) as a suitable platform for Germany’s industrialization. List believed that the key to national security lay not in the pursuit of laissez-faire policies, but in the development of a nation’s productive powers – that is, its scientific, technological, educational and transport infrastructure, together with its systems of public administration, law and order, and self-government. The use of TARIFFS and other forms of protectionism would enable the greatest and most rapid development of national productive powers.

List returned to live in Europe in 1832, where he lobbied for railway construction and economic union as prerequisites for the development of Germany’s productive powers. Despite the literary success brought by the

publication of *The National System of Political Economy* (1841), the impact of List’s ideas on national policy was largely posthumous. Following ill health, List committed suicide near the town of Kufstein in 1846, driven to despair by financial hardship.

The resonance of List’s ideas among advocates of ECONOMIC NATIONALISM and modernization strategies has been enormous. The most common modern incarnation of List’s economic nationalism in political economy is the notion of ‘national systems of innovation’. One important proponent, Christopher Freeman, has argued that List’s conception of ‘the national system of political economy’ might just as well as have been known as ‘the national system of innovation’ (Freeman, 1995: 5). For Freeman and many others (for example, Nelson, 1993), national systems of innovation offer the conceptual key to the comparison and comprehension of national economic performance. Their contention is that those nations that have developed their productive powers in accordance with List’s agenda (for example, Japan and other East Asian late industrializers) have prospered; those that have not (for example, the United Kingdom) have experienced relative economic decline (Freeman, 1987).

Whether List’s system of national political economy or its more recent incarnations form an appropriate conceptual basis for understanding the modern liberalizing global economy is open to debate. The concept of the ‘national’ system may be both too broad (in missing the different systems of innovation across industries) and too narrow (given the transnational nature of institutions in modern innovation systems) to be of future use. Nevertheless, there are those who remain convinced of the contemporary resonance and relevance of the national system of political economy – for example, the authors included in *National Innovation Systems* (Nelson, 1993).

See also:

competitiveness of nations; economic realism; industrial policy; mercantilism

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SIMON LEE

Little, Ian Malcolm David (1918–)

Ian Little, the son of a brigadier-general, went to Eton School and was a Royal Air Force officer from 1939 to 1946. After the war, he went to the University of Oxford where he

obtained a B.A. in 1947 and a Ph.D. in 1949. For more than twenty years (from 1952 to 1976), he was a teaching fellow at Nuffield College, Oxford, except for the two years from 1953 to 1955 when he was working as an economist at the British Treasury, and the two years from 1965 to 1967 when he was Vice-President of the Development Centre of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) in Paris. In 1972, Little became a Professor of Economics at the University of Oxford, but he left in 1976 to become Economic Advisor at the WORLD BANK in Washington. He retired in 1978.

Ian Little made his name as an economist with his *Critique of Welfare Economics*, first published in 1950. In this, he denied that questions of 'efficiency' could be separated from questions of 'equity', since every change in the economy involves a change in the distribution of income, which in turn alters the efficiency condition itself. Thus it is impossible to talk about an optimal situation unless judgements are made about the different distributions of income. This quickly became an established view, but Little was among the first to expound it.

In the 1960s, Little's focus turned to the economics of international aid and of IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI). With Tibor Scitovsky and Maurice Scott, he wrote *Industry and Trade in Some Developing Countries*, which was published in 1970. This contained sharp criticisms of the ISI policies which had been widely adopted in LESS-DEVELOPED COUNTRIES (LDCs) in the 1950s and 1960s. Little, Scitovsky and Scott argued that in too many cases import-substituting industries produced negative value-added when outputs and inputs were valued at border or world prices rather than at the protected prices in the domestic market.

Given this interest in industry and trade, and the earlier focus on WELFARE ECONOMICS, it is perhaps not surprising that Little became involved in jointly producing a manual on cost-benefit analysis with James Mirrlees, another Oxford-based economist. The main thrust of the 'Little Mirrlees' method is simple:

local economic development (LED)

namely, to value all project outputs and inputs at border prices or their equivalent. A book containing the Little–Mirrlees ideas was published in 1974 as *Project Appraisal and Planning for Developing Countries*. The manual and the book gave rise to considerable debate and controversy, with critics pointing out that border prices are far from ambiguous if exchange rates are significantly under- or over-valued, and that border prices are even more problematic if the project output is a non-traded good. In the light of these debates, the book quickly became a widely used text in development economics and the Little–Mirrlees approach has been adopted by numerous policy-makers in LDCs.

See also:

import substitution; trade policy

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CHRIS EDWARDS

LOAN PUSHING *see* debt crisis

LOANS AND THE DEBT CRISIS *see* debt crisis

local economic development (LED)

‘Local economic development’ (LED) is a form of economic policy based on territorial units at

the subnational scale, developed in response to DEINDUSTRIALIZATION. Political, economic and historical conditions have created two faces to LED (which may, in practice, be simultaneously pursued):

- 1 Situated in opposition to ineffectual central government regional development policy,
 - (a) mobilization of local government as employer and purchaser in the local economy, and
 - (b) enhancement of endogenous growth through **SECTORAL PLANNING**.
- 2 Semi-autonomous, or decentralized, economic policy. This is characterized by the creation of incentives to attract **FOREIGN DIRECT INVESTMENT (FDI)** and results in competition between localities.

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ANDY C. PRATT

local–global nexus

AS GLOBALIZATION processes gather pace, instances of global events affecting local societies increase. The global economy affects people worldwide – for example, prices set for primary products in developed countries have consequences for the producers who are often in poor countries. Local demand and market competition in developed countries may force the global price of commodities down, thus impoverishing further the lives of local communities in poverty-stricken producing countries.

In many cities, artefacts from around the world are readily available, thus cultures from one locality impact on other local cultures. The local is distinct from, but is also a part of, the global.

LYN JAGGARD

location theory

The term 'location theory' describes approaches to explaining locational patterns of economical activity. The initial explorations, based on nineteenth-century NEO-CLASSICAL ECONOMICS, were promoted by geographers and associated social scientists during the 1960s. An attempt to build a new 'discipline' – called 'regional science' – around these theories foundered, but the Regional Science Association and its journals remain a forum for such work.

Three main theories underpinned the original work:

- 1 Von Thunen's theory of the location of agricultural land-use, which suggested a concentric zonation of land-uses around a single market;
- 2 Max Weber's theory of industrial location, extended by Edgar Hoover, which sought the least-cost locations for industrial plants, and
- 3 The central place theories formulated by Christaller and Losch, which identified the optimal location for service activities.

Common to all three was an emphasis on the importance of transport costs as a determining factor in the 'idealized' locational decision-making strategies: this commended them to geographers who had been arguing a social scientific rationale for their discipline (geography as a 'spatial science') from the 1950s onwards.

These theories were taken up by pioneering regional scientists, notably Walter Isard, and extended to cover a wider range of subject matter – such as transport networks, flows of people and goods, and the location of different types of residential area within cities. All emphasized the geometrical regularities of the patterns, and deductive models of their creation formed the basis for positive empirical studies of location and spatial interaction, as well as normative evaluations of future patterns. The focus was on spatial structures and associated methods of spatial analysis.

Locational analysis loosely based on such

theories occupied a central role within geography during the 1960s and 1970s in Anglo-American countries, though they only marginally affected other social science disciplines, notably economics. (There has been some interest among economists in recent years – as with Paul Krugman's work on TRADE THEORY – but with little attention to the earlier geographical work.) A key text summarizing the approach (Haggett, Cliff and Frey, 1977), organized its material around the six key components of what was termed the 'spatial structure of a nodal region':

- 1 Spatial interactions: the flows of goods, people and ideas.
- 2 Networks, along which the interactions flowed.
- 3 Nodes: the organization centres on those networks.
- 4 Hierarchies: the spatial structuring of those nodes into centres with differing levels of importance.
- 5 Surfaces: the organization of land-uses within the template formed by the nodes and networks.
- 6 Diffusions: the patterns of change emanating from the major nodes, flowing down the hierarchies and across the surfaces.

Patterns of location and spatial interaction remain a core interest of many geographers, but the search for geometrical regularities has become much less significant in their work. Critiques of the 'classical' approaches focused on their contextual agnosticism and inappropriate behavioural assumptions. Works based in appreciations of MARXIAN ECONOMICS promoted alternative interpretations of spatial structuring of the DIVISION OF LABOUR under CAPITALISM at a variety of spatial scales, while behavioural studies of individual and corporate decision-making emphasized the importance of AGGLOMERATION ECONOMIES and other constraints associated with new patterns of urbanization. The location theories are still used in applied studies, however, using modern information technology (notably geographical information systems – GIS) to

Lomé Conventions

suggest the optimal locations for new facilities, such as car dealerships.

See also:

globalization; perfect competition; perfect information; uneven development

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RON JOHNSTON

Lomé Conventions

The EUROPEAN ECONOMIC COMMUNITY (EEC) and developing countries from the AFRICAN, CARIBBEAN AND PACIFIC GROUP (ACP) signed four treaties in Lomé. Their roots are in the colonial past. The EEC treaty of 1957 associated the colonies of some of the signatories and the first European Development Fund (EDF 1) was established. After decolonialization, international agreements (Yaoundé I and II) were needed. Britain's accession made an arrangement for her future relations to Commonwealth members necessary. Asian Commonwealth countries were not offered association, however. Lomé I thus preserved the dominating influence of Franco-phone states. Spain and Portugal unsuccessfully demanded a comparable extension to include Latin American countries.

Lomé I (1975–80) combined aid and trade measures. EDF 4 was its main financial base and the EUROPEAN INVESTMENT BANK (EIB)

contributed resources. The four conventions mirror political changes in North–South relations very clearly. Lomé I was strongly influenced by the South's call for a NEW INTERNATIONAL ECONOMIC ORDER (NIEO), granting ACP countries far reaching concessions and a contractual right to aid. It contained trade preferences granted unilaterally without reverse preferences for EEC exports, traditional aid, common institutions, a Centre for Industrial Development to foster investments in ACP countries and joint ventures, and commodity protocols (for example, on bananas, rum, sugar) granting advantages to exports of these products. The Sugar Protocol guarantees prices 'within the price range obtaining in the Community' for specific export quantities. A great innovation was the scheme to stabilize export earnings of selected commodities (STABEX), compensating shortfalls like an insurance scheme, which was offered as an alternative to Southern demands for commodity price stabilization. The European Commission's Green Paper of 1996 explained that economic and geopolitical interests during the COLD WAR, and European anxiety at the first oil crisis – a fear of raw material shortages (negotiations started in 1973) – were the reasons for these unprecedented concessions.

Lomé II (1980–5) increased European influence. Rather than extending Stabex (as ACP demanded), a new system for some minerals, Sysmin, was introduced. In contrast to Stabex's automaticity, Sysmin was tightly controlled with the EEC Commission's holding the exclusive right to approve financing. Its director-general for development declared that the importance of these commodities to Europe ruled out automaticity. The EEC propagated a global Stabex, financed by all industrialized countries, and established Compex, a stabilization scheme for the few non-ACP LEAST-DEVELOPED COUNTRIES (LLDCs).

Against ACP opposition, Lomé III (1985–90) introduced strong conditionality and cumbersome administrative procedures. Stabex lost its automaticity. Although this strongly discourages economic development,

financing diversification with Stabex money had now to be justified to the Commission. Criticism that Stabex would hinder development, not valid initially, thus became more convincing. In spite of this 'Sysmin-ization', the ideas of participation, discussion and equality still characterized Lomé III. The Directorate General VIII tried to work out an alternative to STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs), but was soon forced to stop this work.

Unlike the previous treaties, Lomé IV covers ten years (1990–2000). But its financial protocol had to be renegotiated after five years. Negotiations on EDF 8 (1995–2000) were combined with the 'mid-term review' of the convention, used by the EUROPEAN UNION (EU) for important amendments. The revised convention, Lomé IV/2, was signed in Mauritius. Negotiations on a new treaty started in September 1998.

During the Cold War, political and ideological neutrality was characteristic of Lomé. This allowed Angola to sign the treaty as its first step of reorientation to the West in 1985. Lomé IV made political and ideological orientation part and parcel of the treaty. Conditionality and European influence were increased, particularly by the mid-term review. Money earmarked for an ACP country is now disbursed in two separate tranches. The second tranche is conditional on the country's performance and its situation. There is some uncertainty what that precisely means. An essential elements clause was introduced, allowing the suspension of the convention in the undefined event of serious violation of the principles of democracy, human rights or the rule of law. The Commission became more powerful. The dimension of EDF 8 and the protracted and difficult negotiations necessary to finance it, prove that ACP countries have lost importance. The Commission officially acknowledges this by citing a shift of European interests, speaking repeatedly of a 'post-Lomé world'. The negotiations for the treaty after Lomé IV, by now no longer called Lomé, were largely characterized by the EU's desire to establish the situation initially wanted in 1975:

- 1 Disintegrating the ACP group into regions: several FREE TRADE AREAS instead of one set of arrangements with all ACP countries are envisaged. The process of differentiation has started already. Acceding to Lomé IV, the Dominican Republic, an important sugar exporter, was not permitted to accede to the Sugar Protocol. *De jure* a member, the Republic of South Africa was denied most ACP rights.
- 2 Reinstating reverse preferences as under Yaoundé: unilateral preferences were granted under US and ACP pressure.
- 3 Substituting 'flexible' EU decisions on aid allocation according to 'merit' and undefined 'performance criteria' for contractual restrictions. The Commission states that 'primarily political' conditions should be met. The EU refuses to bind itself by treaty.

A shift in favour of private business and non-governmental organizations (NGOs) is clearly discernible. Integrating Lomé resources into the EU budget (that is, abolishing the separate EDF) was discussed. It remains to be seen which parts of Lomé will survive scrutiny by the WORLD TRADE ORGANIZATION (WTO). As the fate of the Banana Protocol privileging ACP bananas shows, commodity protocols and the preferential treatment they grant may not survive.

Lomé, and Stabex in particular, have frequently been criticized for not changing ACP economies perceptibly or for failing to prevent ACP shares in EU trade from declining. Evaluating such criticism, Lomé's resources must be considered. EDF 7 and Stabex amounted annually to ECU2.4 billion and ECU300 million, around 5 and below 1 per cent respectively of total OFFICIAL DEVELOPMENT ASSISTANCE (ODA) by all members of the DEVELOPMENT ASSISTANCE COMMITTEE (DAC). Trade preferences are not very valuable, as most ACP exports were not subject to restrictions anyway. Rules of origin are considered prohibitively cumbersome. Policy incoherence damaged development efforts, such as subsidized EU beef exports undermining EU aid to local beef production. In spite of contractual commitments and the MAASTRICHT

London, City of

TREATY, the Commission refuses expressly any commitment to coherent policies. Still, success stories (such as Mauritius) exist.

A new treaty signed at Cotonou reflects the demise of the 'Lomé System': no more special allocations for raw material policy, trade agreements disintegrating the ACP group (although after a preparatory period) and reviewing the WTO-compatibility of commodity protocols. As EDF 9 stipulates not a fixed amount but up to €13.5 billion, and as disbursement backlogs, the Commission's administrative inefficiency and its new geopolitical predilections are known, it remains to be seen how much money ACP countries will actually receive.

See also:

European Currency Unit (ECU); Uruguay Round

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KUNIBERT RAFFER

London, City of

The City of London is the oldest of the world's three major financial markets (New York and Tokyo being its principal rivals). 'The City' is the shorthand used to denote the concentration of financial institutions (including around 600

foreign banks), equity and foreign exchange markets which are concentrated in the Square Mile at the geographical heart of London.

The City of London's status as a global commercial and financial centre long predates the INDUSTRIAL REVOLUTION. For example, the Bank of England was founded in 1694, by which time a highly developed market in stocks had also developed in London. The longevity of the City's presence has led Geoffrey Ingham to contend that 'British capitalism has maintained a distinctive dual character - as the first industrial economy and as the world's major commercial entrepot' (Ingham, 1984: 6). The competitive advantage in financial services enjoyed by the City is in part a reflection of London's favourable time-zone position, which permits dealers to trade for comparatively long periods with both North American and Far Eastern financial markets. It is also a reflection of the widespread use of the English language in commercial and financial transactions around the world.

To reverse its declining international competitiveness, in 1986 the City underwent a 'Big Bang' package of DEREGULATION and reforms which abolished minimum commissions on dealing, established the capacity for firms to act as both stockbrokers and stockjobbers, replaced face-to-face dealing with computerized transactions and extended membership of the London Stock Exchange to corporations, including foreign institutions. These measures, allied to the Thatcher government's earlier abolition of the remaining controls over capital movements, attracted a large influx of foreign investment.

During the 1990s, the City's status as the major centre for international finance and commerce in the European time-zone has been threatened on three fronts: (1) by the threats posed to the City's successful operation by a number of terrorist bombs and London's crumbling transport infrastructure; (2) by a series of major financial scandals, notably the collapse of the Bank of Commerce and Credit International and of Barings (one of the City's oldest merchant banks), which have called into question the adequacy of the surveillance and

regulation of London's financial markets, and (3) by the United Kingdom's decision not to participate in the first wave of European Monetary Union (EMU), which has raised concern about a loss of business to rival financial centres in Frankfurt and Paris.

Despite these threats, a fresh wave of foreign investment, including plans to develop a new phase of Canary Wharf (the new financial and trading centre in London's Docklands), promises a prosperous future for the City.

See also:

Black Wednesday; Hutton, Will

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SIMON LEE

London Club

The 'London Club' is an informal grouping of commercial banks that provides the framework for rescheduling developing debt to private creditors (though in recent years it has been replaced to some extent by the Bank Advisory Committee). The group nature of rescheduling negotiations has ensured both a uniformity of

treatment of different debtors and that all creditors are brought into the various agreements made.

The London Club grew up in the wake of the expansion of commercial lending to DEVELOPING COUNTRIES in the 1970s and, despite the lack of a formal secretariat, it is in many respects similar to the PARIS CLUB for official debt rescheduling. The key features of London Club operations are that (1) all creditor banks must be involved (this group varying from debtor to debtor), though smaller ones are often represented by larger banks, and monetary authorities have on occasion used various measures to ensure participation, and (2) a debtor must have an INTERNATIONAL MONETARY FUND (IMF) agreement to enter talks with the Club. Differences from the Paris Club include the fact that (1) interest obligations are not rescheduled, but new money lent (Paris Club negotiations only concern existing loans), and (2) multi-year rescheduling is preferred, whereas the Paris Club resists agreements of more than twelve months.

The London Club has proved successful in gaining participation of all creditors, thus overcoming the FREE RIDER PROBLEMS inherent in debt rescheduling. It has been a key institution in enacting the central principles adopted for LESS-DEVELOPED COUNTRY (LDC) DEBT MANAGEMENT: namely, that debtors accept responsibility for all previously contracted debt and do not unilaterally alter their repayment schedules, that the adoption of IMF programmes serves as a condition for further funds, and that (during the 1980s) commercial banks rescheduled at current commercial rates and charged penalties and fees on top of that. Together with the Paris Club, the London Club constituted a creditors' cartel (see CARTELS) which enabled these conditions to be enforced on the debtors.

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London inter-bank offer rate (LIBOR)

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HOWARD WHITE

London inter-bank offer rate (LIBOR)

The 'London inter-bank offer rate' (LIBOR) is the rate at which banks are prepared to lend deposits in the London inter-bank market. The most important and widely used LIBOR is the one for dollar deposits – that is the one at which the banks set in London are prepared to lend dollars to other banks. However, LIBORs are quoted also for a number of other currencies widely traded in London. In particular, with the introduction of the euro on 1 January 1999, London has started quoting the euro-LIBOR. This is the offer rate for euro-deposits in London (that is, off-shore deposits in euros) which rivals the EURIBOR – the rate offered by the banks within the European Monetary Union (EMU) area.

The LIBOR is an important point of reference for banks, since it indicates the cost of raising immediate marginal funds. Therefore, many bank INTEREST RATES are tied to the LIBOR, which is the benchmark for many financial transactions.

Since LIBOR, by definition, is a variable benchmark, it is used in financial transactions to hedge against interest-rates risks by setting the interest rate of financial operations (particularly bank lending to non-bank customers) at the level slightly above LIBOR.

L.S. TALANI

London Metal Exchange (LME)

The 'London Metal Exchange' is one of the two institutions of the City of London that deals with organized commodity markets, the other being the so-called 'Futures and Options Exchange' (or London FOX). Whereas the

latter deals with 'soft' commodities, the LME is responsible for the management of six metal markets: copper, tin, lead, zinc, aluminium and nickel. Members of the London Metal Exchange can deal in any of the six metals listed in the exchange.

The six metal markets are both 'physical' markets, on which raw materials are bought and sold, and 'future' markets (also called 'terminal' markets), on which people insure against price changes. Many efforts have been made to increase the amount of 'physical' business carried out by the LME. The result is that, although only a small proportion of the world trade of these metals actually passes through the LME, it has a big influence on their prices.

L.S. TALANI

long cycles

The existence of regular cyclical movements in the economy is nowadays regarded as a fairly non-controversial fact. The three- to four-year Kitchin cycles in inventories and the seven- to eleven-year Juglar cycles of investment are both widely recognized. When it comes to the fifteen- to twenty-five-year Kuznets cycles (long swings) in building, the forty- to sixty-year Kondratieff cycle (long wave) and the even longer WAR CYCLES and HEGEMONIC CYCLES there is more controversy as to their fundamental character and very existence.

Early work

Already in the nineteenth century, some social scientists – Clarke, Jevons, Tugan-Baranowsky and Wicksell – had recognized the existence of long-term economic fluctuations in agricultural production and prices. They did not, however, advance far beyond simple observations of the fluctuations to produce a theory or model of the recurrent long-term economic ups and downs. The first attempt to present a theory of long waves was put forward by Marxist economists at the beginning of the twentieth

century. Both KARL MARX and Engels had been aware of the importance of the reproduction cycles of fixed capital and the fundamental structural changes that industrial and technological revolutions brought about. These caused the capitalist economic development to take the form of regularly recurring periods of expansion and depression. Helphand – writing in 1901 under the pseudonym ‘Parvus’ – described capitalism as growing in a cyclical pattern, with long periods of capital expansion (*Sturm-und-Drang-Periode*) followed by long periods of contraction. Van Gelderen argued in 1913 that long-term cyclical variation (‘spring-tide’ and ‘ebbtide’) of prices, output and trade was basically caused by the opening up of new territories and the establishment of new lines of production. In 1925, De Wolff argued that the long wave was caused by an ‘echo cycle’ of the reproduction of long-lived capital goods and infrastructural investments.

Kondratieff and Schumpeter

These early studies did not have a long-lasting influence, however. It was first with the works of Nikolai Kondratieff (in the 1920s) and of JOSEPH SCHUMPETER (in the 1930s) that the major analytical and theoretical framework of long-wave theories was given.

Kondratieff’s interest in long cycles was at first only empirical, trying to establish the actual *existence* of long periods with a duration of from forty to sixty years showing alternating rising and declining prices, foreign trade, rates of interest, industrial production and consumption. When later trying to find their *causes*, he argued that these long economic cycles could not be explained by fluctuations in the gold production, wars, revolutions or any other random, exogenous factor, but were due to inherently endogenous and self-generating mechanisms in the capitalist economic system. These mechanisms were basically tied to the recurrent need for replacement and expansion of long-lived fixed capital which does not take place smoothly, but in spurts. Even technological change had to be considered a conse-

quence, rather than a cause, of the dynamics of the capitalist economy.

Critics like Trotsky rather argued that the cycles were generated by forces exogenous to the capitalist economic system (wars, political events and innovations). The upswings and downswings were not really cyclical but only historical ‘epochs of capitalist development’, since they were exogenously generated. Kondratieff’s theory was too deterministic according to Trotsky, who by emphasizing exogeneity wanted to give more room for social and political CLASS STRUGGLE leading to the once and for all downfall of capitalism.

Schumpeter had a different approach to the problem of long waves. Starting from his theory of economic evolution and research on business cycles, he found the innovations of the entrepreneurs to be the nodal factor. The innovations clustered over time in periodic bursts of activity in certain ‘leading sectors’ and each long wave was propelled by a technological revolution (the steam engine, railway construction, motor vehicles, electricity and so on) that periodically reshaped the economic structure. Each one of the long cycles was unique and driven by different clusters of industries. The upswing of the cycle typically started with new innovations coming into general use and, in a process of ‘creative destruction’, they destroyed the old way of doing things.

Kuznets argued that Schumpeter had not managed to link his basic concepts of entrepreneurs and innovations in such a way as to explain why the opportunities for major innovations had to be discontinuously distributed over time. Schumpeter could not explain the recurrent ‘bunching’ of the innovations, and the periodic (cyclical) character of the long wave therefore had not been established. To Kuznets, the trends in production and prices basically reflected the ‘life cycles’ of technological innovations in leading sectors of the economy. He also questioned Schumpeter’s methodology and lack of empirical verification of long waves, and later instead put forward his own Kuznets cycle as an alternative; an alternative which, to a considerable degree, only

substituted statistical series for causal and theoretical analysis.

The post-war phase

After the formulation of long-wave theories in the 1920s and 1930s, the debate did not resume until the 1970s. The world economy was again – after thirty years of unprecedented expansion in the industrial economies – approaching a crisis and ERNEST MANDEL (1975) reformulated a long-wave theory, building on Trotsky's approach. In Mandel's theory, the long waves of ups and downs crucially depend on the fluctuation of the average rate of profit in the economy and the social class struggle. Technological change is seen as an effect, rather than a cause, of the long wave.

In the neo-Schumpeterian theory, technological innovations are the engine of economic development. Elaborating on Schumpeter's theory and using new statistical techniques and data, Mensch tried to show – distinguishing between different types of innovations – that 'swarms' of 'basic innovations' discontinuously took place during depressions, forcing entrepreneurs and industries to innovate. Through the creation of new industrial sectors, the whole economic structure was transformed. To Mensch, the long cycle was a reflection of the 'life cycle' the new products had to go through. In the 1980s, other neo-Schumpeterians – like Kleinknecht and Clark, Freeman and Soete – questioned Mensch's empirical evidence and argued that 'basic innovations' were delayed by depressions and that therefore the 'swarming' would rather occur in the recovery phase of the long wave. Freeman later suggested that the notion of 'swarms of innovations' preferably could be substituted by the notion of 'technological revolutions'. Tylecote (1991) and Perez have also – influenced by the French regulationist school – tried to establish the connection between long waves of aggregate output and prices, and their relation to 'technological styles' (based on water and steam transport, steel and electricity, micro-electronics and biotechnology, and so on) and socio-institutional frameworks.

Another approach in the 1970s was taken by Rostow. To him – following Kuznets' idea of characterizing long-term economic development as a succession of 'leading sectors' – economic development and cycles ('trend periods') have to be related to the differential output growth in the various economic sectors. The leading sectors, fuelled by major technological innovations, move ahead of the other sectors. His theory centres on scarcity and abundance of foodstuffs and raw materials. The long cycles in prices reflect the disequilibrium between the demand and supply of foodstuffs and raw materials. Rostow's dating of these long cycles has, however, been questioned.

Some critics have maintained that the long waves basically result from structural changes and growth variations between different countries. More or less stochastic changes are said to have been mistaken for long cycles of economic growth. In an influential critique of the neo-Schumpeterian theories of long waves, Rosenberg and Frischtak have – essentially repeating Kuznets' critique of Schumpeter – questioned if there really exists a plausible theory of long waves based on technological determinants. The existing theories are said not to satisfy logically interdependent requirements on causality, timing, linkages and recurrence. On the other hand, it seems to be hard for any theory dealing with social, political and economic factors that are as long-term, complex and interconnected as the factors dealt with by long-wave theories, to satisfy the stringent requirements set up.

Although there is still some mainly methodological controversy over the long wave – on the trend-cycle decomposition procedures, the use of spectral analysis and so on – the empirical evidence with respect to time series of prices, investment and output gives no reason to question the existence of long waves of economic activity in the Western world since at least the beginning of the nineteenth century. Critics have maintained that long cycles are nothing but random ups and downs in chosen economic variables, but conceptualizing long cycles less strictly – as a kind of regularity in the repetition of certain phenomena in time – seems to be more

in conjunction with the data. Much evidence indicates that we are now approaching the maturity phase in the fifth Kondratieff wave – a wave that started around 1990, based on the new information technology.

Long cycles in global politics

In the 1980s and 1990s, there has also been a renewed interest in the war cycles and hegemonic cycles developed earlier in the twentieth century. The Swedish economist Johan Åkerman had already in the 1920s argued that it was wars, and not innovations and capital investment, that were the main cause of long cycles. Similar theories were later put forward by Silberling in 1943 and Ciriacy-Wantrup in 1936. According to these, the long cycles that we find in political and economic life are essentially defined by wars that mark the end of one hegemonic power and the rise of a new one in 'the world system'. The peaks and troughs of the Kondratieff cycles also coincide with those of the hegemonic cycles. Following suggestions made by Quincy Wright, Modelski and others have developed theories of global political long cycles going back to the fifteenth century in which wars also play a predominant role. They focus on the outbreak every century of global wars that lead to the establishment of a new international order under a hegemonic leader. The neo-Marxist 'world-system school' of IMMANUEL WALLERSTEIN instead emphasizes the development of the core-periphery relation that arose with capitalism. According to Neumann (1997), military strength depends on the prosperity of the economy, and long waves of economic activity and rivalry between nations for economic leadership seem to a considerable extent to be governed by the same laws.

Although the precise conditions governing these cycles remain a matter of debate, the existence of long periods with distinctive patterns of development in global politics and leadership are widely recognized.

See also:

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LARS PÅLSSON SYLL

long run

In economic terms, the 'long run' is associated with the theory of the firm and GENERAL EQUILIBRIUM, and forms one of the basic principles of micro-economics. The concept of the momentary, the SHORT RUN and the long run in the elasticity of supply and demand first appears in *Principles of Economics* (1890) by ALFRED MARSHALL and can be defined in terms of the period necessary for complete adjustments to equilibrium following changes in prices.

Lorenz curve

Furthermore, in the long run, the assumption is made that the firm can vary all fixed inputs to suit the level of production. In other words, a firm can vary its factory size, introduce new techniques of production, hire and fire workers, and negotiate new contracts with suppliers of raw materials. No exact period of time can be set to distinguish the long run from the short run, since these periods vary from firm to firm and industry to industry according to the time required to vary fixed factors of production. For example, a small manufacturing firm could increase fixed factors in a matter of weeks. Conversely, for a major water company the time period may be much longer, since to increase fixed factors would require the construction of a new reservoir and/or water pipes. The difficulty of defining when the short run ends and the long run begins led the economist JOHN MAYNARD KEYNES to make his famous comment that 'in the long run we are all dead'. Keynes' pronouncement was a reaction to the belief of classical economic theorists that markets tend to return to equilibrium quickly – that they are self-correcting – with the result that there is little scope for government intervention. Conversely, KEYNESIAN ECONOMICS argues that markets may actually take a lot longer to reach equilibrium and that intervention can create short-run changes in demand to stimulate or suppress economic activity.

See also:

equilibrium theory; interest rates

JASON P. ABBOTT

Lorenz curve

The 'Lorenz curve' is among the most widely used techniques to display and analyse the size DISTRIBUTION OF INCOME and wealth. The distribution of income and wealth to individuals and households is known as the 'size' distribution, as opposed to the distribution to the owners of the factors of production which

is known as the 'functional' or 'class' distribution of income.

The Lorenz curve is named after its originator, Max Otto Lorenz (1905). Lorenz proposed that the curve be used to compare inequality across countries and changes in inequality through time.

The Lorenz curve is constructed first by ranking members of a population in ascending order from the poorest (those with the least income or wealth) to the richest. Then the cumulative percentage of the population's income or wealth is plotted on the vertical axis, above the cumulative percentage of the population. For complete equality, the curve would be a 45° line: the poorest 1 per cent of the population would receive 1 per cent of the income (or own 1 per cent of the wealth); any 50 per cent of the population would receive (own) 50 per cent of the income (wealth); 99 per cent would receive (own) 99 per cent of the income (wealth). Inequality results in the Lorenz curve falling below the line of complete equality; the degree of inequality is measured by the gap between the two lines. The Lorenz curve allows an ordinal measure of inequality to be discerned graphically. If the area between the line of complete equality and the Lorenz curve is A and the area below the Lorenz curve is B , a GINI COEFFICIENT measured by the ratio of A to $A + B$ can be used to give a cardinal measure to the degree of inequality.

See also:

Gini coefficient

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CHRISTOPHER J. NIGGLE

Louvre Accord

The 'Louvre Accord' was an ambitious effort by the GROUP OF 7 (G-7) countries in February 1987 to coordinate macro-economic and exchange rate policies (see MACRO-ECONOMIC POLICY) in response to the volatile international capital flows and massive trade imbalances that had caused the collapse of the US dollar since the PLAZA ACCORD. The United States demanded that Japan and Germany increase spending and cut interest rates and taxes, in the hope that stronger domestic demand abroad would reduce the US trade deficit and support the dollar. In return, these governments demanded cuts in the US budget deficit which they blamed for inflating US demand for imports and foreign capital. The GROUP OF 5 (G-5) governments (later joined by Canada) agreed in the Louvre Accord to take modest steps in these directions and to coordinate intervention in foreign exchange markets to maintain the yen and the Deutschmark within loosely defined target ranges against the dollar. Continuing differences over macro-economic policies soon pushed exchange rates outside these ranges and contributed to the stock market crash of October 1987, but Japanese and German reflation did help to shrink trade imbalances and stabilize currencies in 1988–9, at the cost of renewed inflation.

See also:

Group of 7 (G-7), policy coordination in the

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shape cooperation on exchange rate, balance of payments and macro-economic policies.

MICHAEL C. WEBB

Luxemburg, Rosa (1871–1919)

Rosa Luxemburg was a revolutionary Marxist of the Second International who played a pivotal role in the formative debates within European socialism around the turn of the nineteenth century. During a period in which Marxist theory and practice had already begun to sediment into the prevailing orthodoxies of Left and Right, she remained perhaps the most original and independently minded thinker of her generation.

The youngest of five children born into a well-to-do Jewish family, Rosa Luxemburg grew up in Warsaw and was active in socialist politics from an early age. Under threat of arrest, she was forced to leave her native Poland (then part of the Russian Empire) in 1889 and settled in Zurich soon after. She remained there for much of the next decade, studying first mathematics and natural sciences, and then political economy, finally completing her doctoral dissertation on the industrial development of Poland. At the same time, she became involved in the revolutionary politics of the émigré community in Zurich and was instrumental in founding the Social Democracy of Poland in 1894, the precursor to the Communist Party of Poland and a rival organization to the then dominant Polish Socialist Party, whose nationalism she implacably opposed.

However, ambitious for a wider political stage, Luxemburg moved to Berlin in 1898 and it is with German socialism that she is primarily associated. The Social Democratic Party of Germany (SPD) was then the powerhouse of European socialism, by far the largest political party of the working class anywhere. Moreover, among its leaders were the foremost Marxist intellectuals and political strategists of the day (many of them former colleagues of KARL MARX and Friedrich Engels), whose

views carried enormous weight and prestige within the Second International.

Newly arrived in such redoubtable company, Luxemburg was soon drawn into the controversy surrounding the attempt by Eduard Bernstein to recast Marxism as an evolutionary theory of political and social reform. Her rebuttal of Bernstein's position, *Social Reform or Revolution?* (1899), remains perhaps the most cogent defence of revolutionary Marxism against reformism. She maintained against Bernstein that to equate socialism with incremental social reform was to deny the central Marxist insight that the contradictions and crises of capitalism are not temporary, and therefore eradicable, but are rather *systemic*, and therefore inevitable. Consequently, while the struggle for social reform through parliamentary and trade union activity might be both valuable and necessary, it can never be a substitute for the final goal of the socialist movement: namely, the *revolutionary* overthrow of capitalism.

While the SPD officially rejected Bernstein's theoretical propositions, its practical policies and organizational structure became more and more shaped by the caution born of electoral politics. In response, Luxemburg sought to reaffirm the strategic priority of revolutionary struggle within the German socialist movement. This she did by applying the lessons of the 1905 Russian Revolution to the situation in Germany. In *Mass Strike, Party and Trade Unions* (1907), she analysed the events in Russia and from them developed a view of the mass strike as the strategic foundation of international working class revolutionary struggle. By prioritizing the spontaneity and creative activity of the broadest masses, the mass strike tactic would, she suggested, enable the working class to overcome for itself the organizational limitations imposed by the division between the political and the economic spheres in bourgeois society and, as a consequence, link its immediate demands for social reform with the ultimate goal of socialist revolution.

Luxemburg's advocacy of the mass strike tactic only increased the mutual antipathy

between her and the leadership of the SPD, who accused her of 'insurrectionism'. Moreover, in the lead-up to World War I, the SPD all but abandoned its revolutionary ambitions and sought instead to accommodate itself to the imperialist and militarist aspirations of the German bourgeoisie.

Luxemburg's response came in the form of her major work in political economy, *The Accumulation of Capital* (1913), in which she sought to explain the underlying basis of IMPERIALISM and the threat of war that attended it. She argued that the reproduction of capitalism depends on the ability not only to generate surplus value, but also to reinvest it in order to expand production and thereby generate ever more surplus. However, in a closed capitalist economy of finite consumptive capacity, there is no way to absorb all of this surplus value and no reason, therefore, for the capitalist to accumulate it. Given this state of affairs, capitalism would inevitably collapse unless there were an alternative means by which to continue to realize surplus value. According to Luxemburg, this alternative presents itself in the EXPLOITATION of non-capitalist societies – in short, imperialism – and war is at least one mechanism by which capitalist nations struggle for control of this sphere. The problem, however, is that once all such non-capitalist societies are absorbed into the capitalist accumulation process, the problem of closure presents itself once more, only this time with no alternative escape route by which to avoid systematic collapse. It is towards this historical limit that, according to Luxemburg, the logic of capitalist accumulation is irrevocably impelled.

As a consequence of her thesis of inevitable capitalist collapse and her faith in mass spontaneity, Rosa Luxemburg is often accused of a fatalism in her political outlook: put simply, that socialism is the inevitable consequence of economic breakdown. However, this accusation is misguided. For Luxemburg, the consequence of capitalist breakdown is not that socialism is inevitable, but rather that the task of achieving it is made all the more urgent. At the point of breakdown, she argues, the

working class is faced with a stark choice – either struggle for socialism or submit to barbarism. To realize the former and eliminate the possibility of the latter, therefore makes the active and purposeful intervention of the masses on the political stage a necessity.

Luxemburg's opposition to World War I led to her imprisonment for most of its duration. In this period, she authored a trenchant and far-sighted analysis of the 1917 Revolution, *The Russian Revolution* (1918). While she warmly supported the efforts of the BOLSHEVIKS to initiate socialist revolution in Russia, she remained extremely critical of their moves to curtail socialist democracy. The broadest participation of the masses in public life, she argued, was a necessary precondition for a successful outcome to the Revolution.

On her release from prison in late 1918, Luxemburg was thrust into the political turmoil that convulsed Germany following its military defeat. With Karl Liebknecht, she led the Spartacus League in opposition to the newly installed SPD government. Within weeks, however, both she and Liebknecht were dead, butchered by Right-wing soldiers with the tacit consent of the SPD's leadership.

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ROHIT LEKHI

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Maastricht Treaty

More properly known as the Treaty on European Union, the Maastricht Treaty (signed in 1992) was the most significant step so far in the process of European integration. Conceived during the period of 'Europhoria' after the SINGLE EUROPEAN ACT (SEA) and of the almost simultaneous collapse of the communist regimes in Eastern Europe, the treaty was designed to promote continental stability by means of further economic and political integration. It set out precise criteria and a deadline for ECONOMIC AND MONETARY UNION (EMU), and created under the overall title of the EUROPEAN UNION (EU) a three-pillar structure whereby the existing EUROPEAN COMMUNITY (EC) was flanked by the inter-governmentally determined COMMON FOREIGN AND SECURITY POLICY (CFSP) (Pillar 2) and Justice and Home Affairs (later renamed Police and Judicial Cooperation in Criminal Matters

Pillar 3). The treaty also attempted to correct the notorious 'democratic deficit' by expanding the powers of the European Parliament, creating the status of European citizenship and promoting the concept of 'subsidiarity', according to which decisions are to be made as close to the citizens of the EU as possible. Nonetheless, it did not provide a blueprint for European federation as a result of continuing opposition from certain national governments, notably the United Kingdom. The ambitious (but also ambiguous) treaty proved highly controversial: concessions on national autonomy were made to Denmark after its population initially voted against ratification and popular misgivings about the European project became evident in all member-states. Moreover,

the treaty institutionalized the principle of differentiated integration, whereby member-governments can 'opt out' of integration in certain policy areas (such as the single currency). Consequently the ensuing decade was dominated by progress towards economic union; political union, given a high profile at Maastricht, proceeded more slowly, mired in the problem of the 'democratic deficit' and often divergent national agendas.

See also:

Treaty of Rome

ALEX WARLEIGH

Mackinder, Halford J(ohn) (1866–1947)

The geographer Halford Mackinder is often credited with being the 'father' of GEOPOLITICS. Coming from an intellectual tradition which encompassed broad sweeps of history with an environmental determinism, he presented his famous paper on the 'geographical pivot of history' to the Royal Geographical Society in 1904. This posited the imminent end to the dominance of sea power in these 'post-Columbian times', with railways returning land power to world dominance. The great beneficiary of this turn around would be whoever controlled the 'natural' seat of world power in Eurasia, the vast zone of land beyond the reach of naval power. This discovery/invention of the 'pivot area' (later named 'heartland') was taken on board by the German school of geopolitics

in the 1920s and 1930s as the centrepiece to their thinking.

With the coming of air power and thus the elimination of the heartland's invulnerability to outside strikes, it might be thought that the heartland theory would have quietly disappeared into history, but the COLD WAR gave it a new lease of life. The spatial pattern Mackinder described at the beginning of the twentieth century matched the new circumstances of USSR versus United States and its message was that the former's 'natural' advantages had to be countered by nuclear superiority (Walters, 1974; Taylor, 1990). The last promotion of Mackinder as a prophetic genius to save the West came with Reagan's advisors promoting the 'second' Cold War (Gray, 1977; Dalby, 1990).

The longevity of Mackinder's simple geostrategic ideas is quite remarkable. It represents a classic case of using ideas out of context by presenting them as eternal truths. Mackinder was a geographer and politician (serving as a member of parliament from 1918–22) of his times. He was a liberal unionist enthused by tariff reform (he wrote more papers on banking than on geostrategy) as the means of saving the British Empire.

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PETER J. TAYLOR

macro-economic policy

It was not until JOHN MAYNARD KEYNES published his influential *The General Theory of Employment, Interest and Money* (1937) that macro-economics began to be regarded as a

distinctive field of study separate from micro-economics (see MICRO-ECONOMIC POLICY). This separation was driven by the stabilization policy priorities that emerged in the 1930s and during World War II. In parallel, national income accounts were constructed that were compatible with Keynes' theoretical representation of the instruments and targets of macro-economic policy. In essence, macro-economic theory was a body of logic that emerged in the service of policy objectives.

Prior to the publication of the *General Theory*, there was no clear distinction between macro-economics and micro-economics. The classical political economy of the nineteenth century was predominantly macro-economic in content, because of its focus on the interactive behaviour of groups such as rentiers, capitalists and workers. Analytic constructs that we now label 'micro-economic' did not become prevalent until the development of NEO-CLASSICAL ECONOMICS in the late nineteenth century. However, it should be stressed that its founders, such as ALFRED MARSHALL, did not see their 'representative agent' micro-economics as providing analytical foundations for macro-economics. They tended to see this 'mechanical' approach as of use in examining only micro-economic behaviour in the short term.

The most distinctive macro-economic aspect of classical political economy in the nineteenth century was the QUANTITY THEORY OF MONEY (QTM). It was widely believed that monetary expansion caused INFLATION, but classical political economists were more interested in the political conditions that gave rise to monetary expansion and contraction, rather than the nuances of the mechanism itself. Even KARL MARX subscribed to a version of the QTM, but his discussion of monetary policy was inseparable from political considerations. When the mechanism of the QTM became more widely discussed in the early part of the twentieth century by, for example, Irvine Fisher, the focus was more on institutional regularities in the payments system. It seemed to provide a robust theory of inflation and policy-makers used it to justify the application of monetary policy to target inflation, confident that there

would be few lasting effects on the real economy. Generally, the results of such monetary intervention were poor and, by the 1930s, monetary policy came to be seen by many as unpredictable in its timing, uncertain in its effects and even destabilizing in some circumstances.

The experience of the GREAT DEPRESSION seemed to confirm that the private sector did not function like a self-equilibrating Walrasian system of perfect markets. Therefore, governments continued to search for ways of intervening to stabilize their economies. The *General Theory* gave intellectual credence to a view that had already become popular – that governments should use their spending and taxing powers to stimulate depressed economies in order to reduce excessive involuntary unemployment. Keynes argued forcefully that this was a much more direct way of influencing both prices and output, with quicker and more predictable outcomes than those offered by monetary policy.

From the perspective of classical political economy, the notion that ‘public works’ helped to stimulate aggregate demand and reduce unemployment was hardly revolutionary. What was revolutionary was the acceptance that the private sector was capable of reaching positions where chronic under-utilization of resources could persist for significant lengths of time. In the 1930s, this was an uncomfortable position because powerful totalitarian movements, on both the far Right and far Left of politics, also rejected the idea that the private sector could be left to its own devices. FRIEDRICH VON HAYEK argued in his famous and controversial book *The Road to Serfdom* (1944) that, in such a climate, fiscal intervention would constitute the beginning of an inevitable tendency towards TOTALITARIANISM.

As had been the case many times in history, the niceties of this debate were swept aside by the urgency of war, necessitating government intervention on a large scale. On the whole, the victorious governments of the United Kingdom and the United States managed their economies well during World War II – there was no significant inflation, despite the ex-

istence of budget deficits. By 1945, people had become much more accepting of the notion that a mixed economy with significant government intervention could assist, rather than destroy, capitalism.

The post-World War II era saw the application of FISCAL POLICY in earnest, accompanied by accommodative monetary policy aimed at providing very low INTEREST RATES to business investors. Levels of government spending, usually associated with wartime conditions, were attained in building up infrastructure, housing, educational and health services. Macro-economic policy began to be perceived as a powerful tool and Keynesian macro-economics itself was adapted into a form that could be reconciled with neo-classical micro-economics. The logic was as follows: if markets operate effectively, then the neo-classical equilibrium state will be attained; however, in reality, MARKET FAILURES occur, necessitating benign government intervention, not to replace markets by command structures (as the totalitarians advocate) but to assist them to work more effectively.

The 1950s and 1960s were the ‘Golden Age’ of macro-economic policy. The United States and the United Kingdom adopted a similar Keynesian policy stance that was copied widely (see KEYNESIAN ECONOMICS). Two fiscal policy instruments were available: taxation policy and government spending. In the main, the latter was used to promote expansion, but it was always politically and administratively difficult to reverse government spending programmes when the economy overheated. The option of raising taxes was sometimes chosen, often by creating new taxes (rather than by raising existing tax rates) because of political sensitivities. The upshot was that, in most ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) countries, the size of the PUBLIC SECTOR grew rapidly and at a rate faster than tax revenue, resulting in the emergence of significant public debt in the 1960s. Growing borrowing requirements put upward pressure on interest rates, but these were neutralized by increased monetary expansion.

This had two effects: (1) it resulted in public sector deficits being financed, to a significant extent, by printing money and (2) the resultant inflationary environment caused low nominal rates of interest to become negative real rates of interest. All this was no better illustrated than in the case of the United States. The advent of the Vietnam War and ambitious Kennedy-Johnson plans to improve the social welfare system resulted in public deficits that could not be covered by taxation increases and were, to a significant degree, financed by money-creation. MILTON FRIEDMAN was the most prominent critic, issuing warnings of the inflationary consequences of such actions. These were to prove prophetic as double-digit inflation swept the OECD in the early 1970s. Negative real rates of interest, although attractive to debtors, were unattractive to creditors and to their agents (namely, intermediaries in the financial system). With strong pressure from this quarter, there was the beginning of a significant shift in the stance of macro-economic policy, away from 'unemployment first' to 'inflation first'. This came under the banner of MONETARISM, which was really a variant of Keynesianism in its ascendant neo-classical synthetic form. The emphasis of macro-economic policies shifted sharply towards active monetary control, particularly after attempts to curb inflation (using prices and incomes policies) failed in the early 1970s.

As governments began to realize that monetary control is considerably easier if the public-sector budget is balanced, there was a rise in a 'post-monetarist' school of thought that argued that governments should abandon all attempts to use macro-economic policy to stabilize fluctuations in economic activity. By the 1980s, this so-called 'new classical school' began to replace monetarism as the most favoured school of macro-economic thought in the United States, turning attention away from traditional concerns with demand management towards the 'supply-side' of the economy. The rise of monetarism had been very much 'stage-managed' by representatives of the banks and other financial institutions – most notably in London through the Keith

Joseph Margaret Thatcher group in the British Conservative Party. Paradoxically, the demise of monetarism came from the same source. The failure of central banks to use the supply of money effectively as a policy instrument had led to unanticipated damage to both the business community and financial interests. Very high real interest rates and overly strong exchange rates were just as unpalatable to the financial system as their opposites. Balancing the budget became the favoured policy to persuade governments to adopt and new classical economics provided the necessary intellectual credibility.

Despite much rhetoric by economists to this effect, in the 1980s the United States did just the opposite – almost unintentionally, the fiscal stance was strongly Keynesian, with large budget deficits being recorded. The Reagan administration conducted one of the most spectacular fiscal expansions in peacetime history, as a by-product of large increases in defence spending (see 'REAGANOMICS'). However, the Vietnam experience was not forgotten: monetary policy was no longer passive and interest rates were driven up to high levels across the OECD as the US deficit was funded by the sale of debt instruments. However, in the United States the adverse effects of these were mitigated by the marked expansionary tendency of the economy. In Europe, particularly in the United Kingdom, the situation was quite different – Keynesian levers were, for the first time in post-war history, being pulled strongly in a contractionary direction, as governments attempted to achieve budget balance. Simple Keynesian macro-economics predicts that cuts in government spending, accompanied by high interest rates, will generate unemployment and this was indeed the outcome.

Despite these deflationary measures, inflation rates were slow to fall and gradually the view that budget surpluses were necessary began to prevail. Thus, the about face of macro-economic policy was complete – the deliberate use of recession was resorted to as an anti-inflation device. The intellectual justification was based on the 'natural rate of unemployment' hypothesis. Expectations, built

into the inflation processes by the sophisticated and the powerful, were to be lowered by dispossessing the weak and unprotected in society of their employment. The strongly redistributive effect of such regressive policies was intensified by the fact that higher income tax rates were also cut and various subsidies to health, education and unemployment insurance were reduced. The rationale for these measures was neo-classical SUPPLY-SIDE ECONOMICS. However, the redistributive outcome also coincided conveniently with the traditional political goals of Conservatives. In the expansionary United States, these supply-side economic policies did not induce much unemployment but, rather, a large increase in the number of people who could be classified as the 'working poor'.

The problem with the recessionary policies practised in countries such as the United Kingdom was that they tended to damage the economic structure in some kind of 'hysteretic' manner. Thus, the natural rate of unemployment kept rising throughout the decade in line with the actual unemployment rate; thus, more and more recession and unemployment seemed to be necessary to lower inflation. However, new classical economists and 'real business cycle' theorists rarely saw this as a structural problem – to them it was simply evidence of regulatory inflexibility on the supply-side of the economy. Regulatory protection in the workplace and the provision of social security benefits to the unemployed were deemed to be too generous, encouraging workers to substitute leisure for work. Such benefits were also viewed as pushing the 'reservation' wage upwards to the detriment of employment.

The policy prescription was to cut taxes and subsidies even further, and to engage in widespread deregulation and privatization. By the 1990s, the ascendancy of such views had become so complete in the United States that Bill Clinton could preside over a programme that, in many ways, was more severe than that of his Right-wing Republican predecessor, Ronald Reagan. It was a policy stance that suited the financial sector – by the mid-1990s

OECD inflation had finally reached a very low level when compared to the 1950s. By the late 1990s, it was difficult to discern the presence of any kind of macro-economic policy of the type pioneered by Keynes.

Macro-economics had become aggregated neo-classical micro-economics with two branches: the unaptly named 'new Keynesian' school, offering complex market failure arguments that suggested a role for government as a more sophisticated 'market-maker' – however, the policy focus was almost always 'supply-side policy first and demand management second'; the other 'real business cycle' branch adopted a strict neo-classical 'single agent economy' representation that was so removed from actual historical time that it could not accommodate any sort of detail concerning government policy. When an optimal world is specified which has no government, then it is tautological to say that government intervention cannot be recommended.

With such a pronounced absence of any guidance from macro-economic theory, policy-makers were left largely to please their political selves as to what they should do. With little more than the rhetoric of competition and EFFICIENCY in an abstract neo-classical economic model to rely on, governments were free to dismantle the public sector and cut public spending, arguing that such measures could only enhance employment and productivity. In reality, of course, such measures were often motivated by political goals and, in consequence, created monopoly power and inefficiencies.

The death of macro-economic policy can be thought of as a decline in the moral and ethical content of economic policy-making that was so strongly upheld by early neo-classical economists, such as Marshall. Macro-economic policy was devised by his pupil, Keynes, as a means of reducing the impact of fluctuations of economic activity on the standard of living of the poorer sections of our societies. In place of macro-economic policy, we have had micro-economic reforms that were supposed to make us 'all' better off, yet they consistently made the rich richer and the poor poorer. Moral

responsibilities aside, such an outcome is also wholly inconsistent with Paretian criteria, which have been the cornerstone of mainstream WELFARE ECONOMICS for most of the twentieth century.

However, there is little doubt that old-style Keynesian policies are of limited relevance in the post-millennium era, given that our economies have changed so markedly. Keynesian macro-economic policy was effective in a crude sense, but attempts to 'fine tune' it proved to be very difficult. Governments clearly faced difficulties in engaging in complex intervention in an economy that was, itself, becoming more complex. Confronting this emergent complexity will pose a major challenge to macro-economics in the coming decades. This will involve an understanding of the non-linear character of economic systems and, in turn, a related understanding of the changing role of legal, political, regulatory and institutional arrangements. Macro-economists are generally not trained to approach the economy in this way. It follows that, in order to have new and useful macro-economic policies, a second revolution in macro-economics is required.

See also:

depressions; economic policy, national; gross national product (GNP); Keynesian economics; laissez-faire

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JOHN FOSTER

Mahalanobis, Prasanta Chandra (1893–1972)

Mahalanobis was born into a middle-class Bengali family in Calcutta and was educated first at Presidency College in Calcutta, and then at King's College, Cambridge, where he obtained a first class degree in natural sciences. He was Professor of Physics at Presidency College for nearly three decades.

Mahalanobis was a modern Renaissance figure, with interests in physics, literary criticism and architecture, but it was his work on statistics and especially on the design of sample

surveys that established his international reputation. He was involved in founding both the Indian Statistical Institute in 1931 (of which he was Director and Secretary until his death in 1972) and *Sankhya: The Indian Journal of Statistics* in 1933. In 1946 he became a Fellow of the Royal Society.

Although he was influential in theoretical and applied statistics, Mahalanobis' political influence was strongest in the 1950s, through his involvement in Indian economic planning. India's Second Five Year Plan (1956–61) was based analytically on models developed by Mahalanobis, in which he drew on the work of Feldman (a Soviet economist of the 1920s) and Harrod and Domar (see HARROD–DOMAR GROWTH MODEL). Mahalanobis' growth models used a fixed capital/output ratio and paid little attention to labour supply and foreign trade. His two-sector (consumption goods and capital goods) model highlighted the trade-off between present and future consumption, and generated lively debates about balanced growth and the need for a critical minimum investment to break out of a vicious circle of poverty.

Using his four-sector model, in which consumption goods were split into three subsectors, Mahalanobis developed a 'dual-development thesis' in which a high weight can be attached to investment in capital goods in the interests of long-term growth, alongside a heavy emphasis on a highly labour-intensive consumer goods sector to soak up a labour surplus. This thesis has been likened to the 'Walking on Two Legs' policy adopted by Mao Zedong's China in the late 1950s.

Towards the end of his life, following differences with Nehru over the work of the Planning Commission in India, Mahalanobis returned to issues of statistical methodology. However, in the field of international political economy (IPE), it is his much discussed models for economic planning that are still most significant.

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CHRIS EDWARDS

Malthus, Thomas Robert (1766–1834)

Thomas Malthus was a leading economist of the classical era of political economy. Although he sided with the classical school on a number of basic issues, he differentiated himself from it on at least one crucial point: he did not accept the validity of SAY'S LAW.

Malthus was son of a country gentleman. He studied at Jesus College, Cambridge, where he also taught for a while after he had been ordained as a curate. In 1805, he was appointed Professor of History and Political Economy at the East India Company's College in Hertfordshire (see EAST INDIA COMPANY), a position in which Malthus remained until his death.

Malthus became famous as an economist after publishing, anonymously in the first edition of 1798, his *An Essay on the Principle of Population as It Affects the Future Improvement of Society*. His work on population aimed at showing that the cause of poverty could not be traced in the social system, but the contradictions of nature (that is, humanity's unbounded desire for multiplication on one hand, and the limits to the increase in terms of the means of subsistence on the other). His theory on population created a new school in political economy called 'Malthusianism'. In the 1870s, this school had great success as NEO-MALTHUSIANISM.

Malthus (having taken into account data concerning the population increase in the United States) took his stand on three propositions: (1) that the population has the tendency to

increase in geometric progression; (2) that the growth in the amount of means of subsistence follows an arithmetical progression, and (3) that the poverty of the mass is simultaneously a result of the divergence between the quantity of means of subsistence and the size of population, and a means for eliminating this lack of balance.

Malthus' first proposition presupposes the existence of a 'natural' law of population. But, in fact, the population's rate of augmentation depends on various economic and social conditions in each historical era. His second proposition (based on the so-called 'law of diminishing returns' – see DIMINISHING RETURNS – or 'law of diminishing fertility of the soil') ignores, just as the first one does, the historical conditions (for example, the development of labour's productivity and the progress of agricultural technology). The third proposition (which is nothing but the consequence of the two others) composes Malthus' doctrine of absolute overpopulation.

From this doctrine, Malthus drew various conclusions. The poor can improve their share of food only if they refrain from early marriage. Grants on behalf of the poor are injurious to them, because they encourage them to multiply; thus Malthus fought against the Poor Laws. Additionally, in a pamphlet entitled 'An investigation of the present high price of provisions' (1800), he blamed the Poor Laws for increasing the demand for corn by the poor and thus increasing the price of corn above its previous market levels.

Nevertheless, while he maintained his opposition against allowance systems in general, for one of the same reasons he blamed it, he also supported it in special circumstances of scarcity caused by bad harvest: higher prices also lead to greater incentives to farmers to increase next year's crop. However, Malthus' real support was not for the allowance system itself, but for the maintenance of the protectionist CORN LAWS, as he made clear to the public in his pamphlet 'Observation on the effects of the Corn Laws, and of a rise or fall in the price of corn on the agriculture and the general wealth of the country' (1814): TARIFFS on imported

corn and high corn prices are beneficial for agriculture because they lead to an increasing output of the means of subsistence. Briefly, the objective meaning of Malthus' thesis was to defend landowners' interests.

DAVID RICARDO owes his theory of differential rent to Malthus' writings. Malthus stated this idea during the debates on the price of corn during 1814–15 in two of his pamphlets: 'An inquiry into the nature and progress of rent, and the principles by which it is regulated' and 'The grounds of an opinion on the policy of restricting the importation of foreign corn: Intended as an Appendix to "Observations on the Corn Law"' (both published in 1815). However, in his *Principles of Political Economy Considered with a View to Their Practical Application* (1936 [1836]), first published in 1820, Malthus criticized sharply the way in which Ricardo had incorporated the theory of differential rent in his analysis. According to Malthus, Ricardo did not take into account the fact that in the long run there is a slow but steady improvement in fertility of soil, parallel to POPULATION GROWTH. Malthus' analysis had an ulterior motive, for which he did not hesitate to confront his own previous analysis about the diminishing returns of the soil: his motive was to support, once again, the landowners' interests by showing that they are not in opposition to the general progress – for the increase of rents keeps step, in the long run, with the increase of profits and of means of subsistence.

Another point of disagreement between the two men was the theory of value. Malthus' argument, in his *Principles*, was that the value of the commodities is regulated by the principle of supply and demand, and is determined by the costs of production – that is, WAGES plus profit (and rent). Costs of production are also regulated by the very same principle: the principle of supply and demand. The latter came to constitute one of the basic points of Marshall's neo-classical theory.

But the chief issues of disagreement between Malthus and the political economy of the Classics were his critique, in *Principles*, of Say's Law and his analysis of the possibility of crises

of UNDERCONSUMPTION; a critique that served the same aim as mentioned before – the defence of landowners' interests. While the Classics (Ricardo, James Mill, Say) believed that there is no possibility of a generalized OVERPRODUCTION of COMMODITIES, since production creates its own demand, Malthus (together with Simonde de Sismondi) considered that unlimited CAPITAL accumulation and growth of production may lead to crises because of insufficiency of demand compared to supply.

Malthus criticized the Classics' notion of MONEY being a mere exchange medium, which resulted in their conception of commodity circulation as an uninterrupted barter-like process; if so, crises of overproduction (from the point of view of commodity circulation) would be impossible. But the main point of Malthus' thesis was the potentially destructive function of saving. According to him, if saving overcomes a limit, the labourers' unemployment will increase due to the hysteresis of the 'effective demand' in relation to production (that is, of the demand which is sufficient for commodity prices equal to the cost of production plus the capitalist profit). In Malthus' argument, the increase of demand lags behind the growth of production, since he presupposed that the savings are invested in productive labour (a thesis which is rather closer to the models of POST-KEYNESIAN ECONOMICS than to the analysis of J.M. KEYNES himself, as the latter presupposed that *ex ante* savings are in excess of *ex ante* investments). The problem of insufficient demand is considered to be the result of (1) the labourers' low CONSUMPTION in comparison to the increasing production, and (2) the capitalists' objective of high savings. But if capitalists restrain themselves from consuming their profits, then (according to Malthus) non-productive consumption of landowners, their servants and other (according to ADAM SMITH) parasites, together with state expenditures, may compensate for the lacking demand.

Malthus' argument is extremely weak: if the capitalists invest their profits in productive labour, as Malthus presupposes, then the 'effective demand' will increase in the form of

production and consumption means. So why should capitalists prefer not to accumulate capital for the purpose of new profits, but to 'gift' their profits to parasites or to the state? Keynesianism, one of the leading trends of economics in the twentieth century, adopted some of Malthus' ideas about the lagging behind of 'effective demand', incorporating them in a new conceptual framework.

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— (1966 [1798]) *An Essay on the Principle of Population as It Affects the Future Improvement of Society*, London: Macmillan. First edition, in which Malthus provided the bases of his population theory.

In addition, several of Malthus' pamphlets can be found on the internet at <http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3113/malthus/index.html>: 'An investigation of the present high price of provisions' (1800); 'Observation on the effects of the Corn Laws, and of a rise or fall in the price of corn on the agriculture and the general wealth of the country' (1814); 'An inquiry into the nature and progress of rent, and the principles by which it is regulated' (1815); 'The grounds of an opinion on the policy of restricting the importation of foreign corn: Intended as an Appendix to "Observations on the Corn Law"' (1815). These pamphlets reflect Malthus' immediate economic and political interventions in the context of class struggle.

GEORGE E. ECONOMAKIS

managed currency

A 'managed currency' is one the value of which has not been fixed by the forces of the free market, but rather has been influenced by the

Manchester School

government – either by buying and selling its own money or some other mechanism. In order to manage a currency, central banks hold reserves in the form of gold, FOREIGN EXCHANGE and SPECIAL DRAWING RIGHTS (SDRs). Most currencies in the contemporary international monetary system are managed in some way, even when they are allowed to float. This can cause difficulties, such as competitive exchange rate depreciation.

See also:

currency depreciation; exchange rate; exchange controls; foreign exchange reserves

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ALISON M.S. WATSON

Manchester School

'Manchester School' was Disraeli's term for the nineteenth-century Lancashire cotton manufacturers and politicians who advocated FREE TRADE. Opposition to the CORN LAWS was the group's single unifying issue. While it is common to consider members as subscribing to a LAISSEZ-FAIRE economic policy as the best means of achieving prosperity and growth, they were far from unanimous on this issue. Many members did, however, oppose public care of the poor and the Factory Acts.

See also:

Cobden, Richard

Further reading

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ROBERT LOONEY

Mandel, Ernest (1923–95)

Ernest Mandel was a Belgian Marxist political economist and a leading theorist of the Fourth International, which follows and modernizes Trotsky's views and strategies. He grew up in Antwerp, inherited a Marxist, anti-Stalinist and anti-fascist political position from his father, Henri Mandel, and joined the Belgian Socialist Revolutionary Party (which became the central core of the Fourth International) in 1939. He was arrested three times by Hitler's army, but fortunately survived the concentration camps. When the Fourth International took a participatory strategy at the beginning of the 1950s, he joined the Belgian Socialist Party. After the general strike in 1960–1, however, the anti-capitalist movement in Belgium passed its peak and the militant Left, including him, was expelled from the Socialist Party.

Then Mandel began to work on more systematic and theoretical books and articles, on a wide range of topics. His work encompasses four areas: (1) exploration of the basic framework of Marxist political economy, as in *Marxist Economic Theory* (1962) and *The Foundation of the Economic Thought of Karl Marx* (1972); (2) studies of contemporary international politico-economic situations, such as in *Europe versus America? Contradictions of Imperialism* (1970); (3) reconstructions of long-wave theory applied to contemporary capitalism, as in *Late Capitalism* (1972) and *Long Waves of Capitalist Development* (1980), and (4) arguments for socialism

against Stalinist distortions and for a democratic planned economy.

His works heralded the radical students' movements starting in 1968 and the renaissance of Marxist political economy in the West. Perry Anderson's *Considerations on Western Marxism* (1976) therefore cited Mandel and the Trotskyist intellectual activities as proof of a turn away from the separation of theory from practice and towards their reunification in Western Marxism.

Mandel's major contribution to contemporary political economy is initiating a revival of long-wave theory in his *Late Capitalism*. The theory assumes long waves of alternating upswing and downswing of about fifty years' duration in capitalist development. The growth of the Social Structure of Accumulation School in the United States and the Regulation School in France each followed the lead of long-wave theory in their own way. Its impact came also from the fact that the work coincided with the deepening economic crisis of the capitalist world. He inherited Trotsky's view in this theory and argued that the expansive long wave begins with exogenous shocks (such as wars, social revolutions and so on) against a stream of endogenous long-wave theorists, like Kondratieff and JOSEPH SCHUMPETER. However, he added an asymmetrical endogenous theory to Trotsky's view in order to explain the turn from a long upswing to a long downswing, stressing the role of the changing profit rate in shaping the pace of capital accumulation. His formulation was particularly suitable to the historical development of capitalism since World War II.

In arguments for socialism, Mandel designated the Soviet Union as 'a bureaucratically degenerated workers' state' (Mandel, 1978), recapitulating Trotsky's definition. Against the background of *PERESTROIKA* and Eastern European reformist movements, he remained grounded in the more traditional Marxist conception of socialism as a planned economy (desirably with democracy) and debated with A. Nove and others, rejecting the theory of MARKET SOCIALISM (Mandel, 1986; 1988). Many contemporary political economists think

that his views on the crises, the resultant systemic changes and the futures of socialist economies were too narrow and static.

See also:

Marxian economics

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SHOICHI ITOH

Maoism

'Maoism' is based on Mao Zedong's (1893–1976) interpretation of Marxism (see MARXISM–LENINISM) and its application to Chinese conditions. Mao was a founding member of the Chinese Communist Party (CCP) in 1921 and Chairman of the CCP from 1935 to 1976. Mao established the People's Republic of China on 1 October 1949, serving as state president until 1959. As Chairman of the CCP, Mao was considered the political leader of the People's Republic of China until his death in 1976.

Although Maoism touches on a wide variety of topics, several main tenets may be identified. First, Maoism holds that the peasantry should be at the centre of the proletarian revolution. Revolution in the countryside will grow to engulf the cities, at which point the peasantry and the proletariat will form a united front against the bourgeois classes. Second, political power is of primary importance, even over economics, as it allows for the 'dictatorship of the proletariat' to proceed. Third, practice and theory must not be separated, although practice is more meaningful. Verification through

maquiladoras

action is necessary to test the ideas and principles of theory. Fourth, 'revisionism' (which is the desertion of long-term communist goals in favour of addressing short-term problems) must be prevented by consolidating the revolution through thought-reform campaigns and the maintenance of a united front against imperialist penetration.

See also:

class, definition of; communism; Marxism - Leninism; socialism

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J. ANDREW GRANT

maquiladoras

Maquiladoras are 'in-bond' manufacturing plants, situated mostly along the US-Mexican border, that process imported materials for RE-EXPORT, primarily to the United States. The 'in-bond' arrangement, which began in 1965, allows imported materials to enter Mexico duty-free, with the importer posting bond as warranty that the finished product will not be sold in Mexico. Appropriate duties are applied on the value-added when the product is re-exported. If the product is not re-exported, a Mexican duty is collected from the posted bond. *Maquiladoras* have flourished in labour-intensive industries, combining foreign capital and technology with Mexico's low-wage labour market.

One of the original advantages of the programme – the ability to import finished goods from *maquiladoras* into the United States, paying a duty only on the value-added – eventually will be eliminated as all TARIFFS are phased out under the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA). But this

does not mean that the plants will close. Mexico still provides important advantages for coproduction operations that produce goods for markets in the United States.

WILLIAM P. AVERY

marginal propensity to consume (MPC)

The 'marginal propensity to consume' (MPC) is the proportion of any additional disposable income that an individual, group or society will immediately consume, rather than use for saving. Usually, the MPC is between zero and one: an extra unit of income increases consumption, but by less than one unit.

See also:

average propensity to consume (APC); average propensity to save (APS); marginal propensity to save (MPS)

N.M. DUYKERS

marginal propensity to save (MPS)

The 'marginal propensity to save' (MPS) is the proportion of any additional income that an individual, group or society will save, rather than spend on immediate consumption.

R.J. BARRY JONES

marginality

The concept of 'marginality' as used in the political economy and development literature was largely developed by Latin American social scientists in the 1960s and 1970s. Two theoretical interpretations of marginality came to the fore. One group, working within MODERNIZATION THEORY, view marginality as

lack of integration of certain social groups in society; the other, working within Marxist theory (see MARXISM–LENINISM), view marginality as arising from the conflictive nature of the integration of the THIRD WORLD into the world capitalist system. Policy recommendations differ: while the former group argue for measures aimed at integrating the marginal groups into a reformed capitalist system, the latter argue that marginality is a structural feature of capitalist society and that only a socialist development option can solve the problem of marginality.

The modernization or dualist perspective considers marginality to be a multidimensional phenomenon, as certain individuals or groups are unable to participate in (1) the productive system, as they are unemployed or in relatively unproductive self-employment; (2) the consumption system, due to lack of access to goods and services; (3) the cultural system, and (4) the political system. Marginal people are those groups that are located at the inferior end of the social scale or, more precisely, outside it, as they are not integrated culturally, socially or economically into society. Marginals do not belong to and have even been rejected by the economic system. In sum, while marginal groups are juridically members of a nation, they lack direct involvement or participation in its affairs. Marginal groups are largely composed of the poor peasantry and in the urban areas by (1) the self-employed who work in such relatively unproductive activities as small handicraft manufacture, street selling, seamstressing or shoe-shining, and (2) low-qualified wage workers such as casual construction workers, porters, carriers, domestic servants, garbage scavengers and night-watchmen, who find only occasional employment in low-paid jobs. Most urban marginals live in suburban shanty towns and inner-city slums.

By the late 1960s, the modernization view on marginality was being challenged (and its dualist thinking in particular) by thinkers working within STRUCTURALISM and NEO-MARXISM. These argued that the problem of marginality is structural, as it is embedded within the process of dependent capitalist

development of the Third World. Marginals, far from being out of the system, are an integral part of it, though at the lowest level. Their condition is that of a subproletariat, as they suffer the most acute forms of domination and EXPLOITATION. The theoretical weakness of the modernization position of marginality stems from its failure to recognize the class nature and conflict of society, and the inter-connections between the marginal and integrated sectors, as well as between the developed and underdeveloped countries within the world capitalist system. Marginality reflected a particular manner of social integration and participation characteristic of dependent countries, rather than non-integration or non-participation as modernization theorists claimed.

In the view of José Nun (1969) and Aníbal Quijano (1974) a new phenomenon, not foreseen by Marx, has emerged in the dependent LEAST-DEVELOPED COUNTRIES (LLDCs). In Marx's analysis, the relative surplus population performs the following functions within the capitalist MODE OF PRODUCTION. First, it provides a plentiful reservoir of labour which can be drawn on during the upward swing of the economic cycle. Second, it forces those in employment to work harder for, and subordinate themselves further to, capital. Third, it exercises a downward pressure on wages. However, in LDCs the penetration of MULTINATIONAL CORPORATIONS (MNCs) has created such a large relative surplus population that part of it is not only afunctional but even dysfunctional for CAPITALISM. This part of the relative surplus population does not perform the function of an industrial reserve army of labour, as it will never be absorbed into the capitalist sector having been excluded from it. For this reason, Nun and Quijano feel justified in coining the concepts of 'marginal mass' and 'marginal labour' respectively.

The question then arises as to how this marginal mass or labour make a living. An increasing proportion seek refuge in what Quijano calls the 'marginal pole' of the economy, which in the development literature was subsequently referred to as the INFORMAL ECONOMY. With the emergence of a marginal

pole, the overall economic structure becomes even more uneven, heterogeneous and contradictory, thereby accentuating the disequilibrium between the monopolistic, competitive and marginal levels of the system. The marginal pole is the lowest level of the economy, but one which is far from constituting a separate sector, as it is directly linked to the process of realization of SURPLUS VALUE and, fragmentarily, to the productive process. However, these relationships are unstable and precarious.

The concept of marginality has generated a lively debate, largely from a broad Left-wing and Marxist perspective. Critics query the need for new concepts and hold that existent Marxist categories are adequate. The discussion has centred on three major issues, some of which are closely interrelated: (1) the extent to which the marginality concepts differ from Marx's industrial reserve army of labour, (2) the contribution of marginals to the process of capital accumulation and their articulation to the dominant mode of production, and (3) the relationship between marginality and dependency.

The term 'marginality' lends itself to misinterpretation, as the phenomenon it describes – far from being 'marginal' to capitalism – is an integral part of its present-day dynamics and existence. The contribution to capital accumulation of the marginal sector is far greater than suggested by marginality analysts. Most marginals are labouring under pre-capitalist social relations. However, these relations are held to be closely articulated to capitalist RELATIONS OF PRODUCTION, forming a single system in which the logic of capital predominates. The development of capitalism thus not only destroys pre-capitalist relations, but also reproduces and creates these relations. While pre-capitalist relations are subordinated to capitalist relations, they both form a totality in which the pre-capitalist sector makes a significant contribution to the capital accumulation of the capitalist sector. Thus, the emphasis is on UNEVEN DEVELOPMENT in Third World social formations.

The analysis of marginality undoubtedly opened up a useful debate on an important issue for the WORLD ECONOMY, as Third World labour can be considered to be the industrial reserve army for capital under GLOBALIZATION. Despite some shortcomings of marginality studies, their merit has been to draw attention to the plight of a vast and heterogeneous mass of impoverished Third World labour and to their contribution to capital accumulation on a world scale.

See also:

dependency theory; unemployment, hidden

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CRISTÓBAL KAY

market failures

Market failures arise when social costs and benefits differ from private ones, and as a result an unregulated market fails to produce an optimal allocation of resources. Where there

are significant market failures, government intervention is generally justified. Market failures are pervasive.

The major sources of market failures are: (1) the neglect of income distribution and poverty in the definition of optimal resource allocation – this is a particular concern in the THIRD WORLD, but is also relevant in developed countries; (2) the prevalence of significant EXTERNALITIES; (3) the existence of indivisibilities and cumulative processes of learning and technical change; (4) the absence of perfect information and consequently the existence of incomplete markets, and (5) the important role of institutions in development. Each of these failures means that the unregulated market will not bring about a welfare optimum. While some are, in theory at least, relatively straightforward to 'correct' by government action, others are more deep seated and may not be correctable in any simple sense.

A market equilibrium is consistent with great inequality and poverty: each dollar of gain is treated the same, whether it goes to a starving child or a billionaire. Any *human-centred* definition of welfare would reject this view, instead regarding meeting the needs of the poor as more important than further enriching the well-off. From this perspective, the existence of extensive poverty alongside considerable wealth constitutes a market failure. Markets do not *necessarily* lead to high rates of inequality and poverty, but they often do. For example, where the initial distribution of assets (land especially) is very unequal and education is mainly confined to an elite, markets generally lead to inequitable growth. In contrast, countries which have had radical LAND REFORMS and provide extensive education have much more equitable patterns of development. To avoid this type of market failure, it is necessary for governments to assess the income distribution and poverty effects likely to result from the operations of the market, and take action to offset these effects. This action may include asset redistribution, policies to extend credit to those with low incomes, extensive subsidized education, progressive taxation of incomes, food subsidies,

pensions and other special programmes for vulnerable groups (such as children) and poor groups (especially women and the old).

Externalities occur where market-priced transactions do not fully incorporate the benefits or costs associated with transactions. Externalities can be real or pecuniary, among producers or consumers, and static or dynamic. Where they exist the price system gives the wrong signals for resource allocation. A classic example of a real negative externality is provided by a factory emitting smoke which imposes heavy costs on a nearby laundry as a result of the dirt. An example of a positive externality is if the pollination from the bees on a honey farm benefits nearby orchards. Pecuniary externalities occur when production by one firm results in cost reductions for others: for example, a large-scale energy plant may reduce energy costs so that aluminium smelting becomes profitable. Where few agents are involved, it is reasonable to assume that they would get together to secure an optimal solution (for example, the laundry paying the factory to emit less smoke); where there are many actors, such private action is unlikely because of the high transaction costs involved.

Three types of real externality are particularly pervasive and often of significant magnitude: (1) environmental externalities; (2) worker training plus learning on the job, where the skills imparted by one employer can be costlessly acquired by others when the employee changes job, and (3) dynamic externalities, associated with technological change, when the spread of innovations occurs through producers copying each other. In each, resource allocation can be seriously distorted without government intervention. With environmental externalities, market activities will result in environmental pollution unless restrained by pollution taxes or regulation. Where such externalities are worldwide in effect (as with global warming), the regulations need to be at an international level. In the second case, there is likely to be underinvestment in training. Government training centres or subsidies to training can offset this externality. In the third case, free imitation of complex

technologies may be restricted by patent laws, but they are less effective for simple technologies and government support for technology innovation may be needed. An example is the GREEN REVOLUTION in agriculture, where new seeds were developed with public support (internationally and nationally), which then spread rapidly among small farmers. This type of situation is especially likely to occur where there are many producers producing on a small scale.

Pecuniary externalities arise where there are large indivisibilities leading to economies of scale, heavy TRANSPORT COSTS (and/or other restrictions on international trade) preventing the import of low-cost inputs, and where markets are relatively small (as in many developing countries). Coordination of production decisions, production by public enterprises or subsidization of some large-scale projects may overcome such externalities. In small markets, underinvestment in technologies associated with economies of scale is likely, even where these are internal to the firm, when capital markets are imperfect. Projects may appear too risky for commercial bank lending without some government support (such as interest rate or export subsidies, and/or import restrictions). The car industry in Japan in the 1950s and the shipbuilding or steel industries in Korea in the 1970s provide examples of successful government policy to overcome such market failures.

Much industrial development exhibits a variety of potential market failures: innovation, economies of learning and scale, and the need for supporting activities (such as good transport and communications, insurance, computer support, and so on) all lead to a tendency for underinvestment in industry and ancillary services, because of initial high costs, perpetuating underdevelopment. Yet, with appropriate promotion, internationally competitive industries might develop, while the increased scale of the domestic market would encourage the development of ancillary activities. Industrial intervention must be selective: if too many industries are promoted simultaneously, none may succeed – each failing to reach an efficient

scale of production, leading to high-cost production. Moreover, the selection must take into account the stage of development of the economy, especially skill availability. Promotion should also be of limited duration.

The market failures referred to so far are, in principle, straightforward to correct. In practice, there can be severe problems of political economy – that is, governments unwilling to take action to tackle poverty, while corruption and incompetence may lead to inefficient industrial interventions. Some have, therefore, claimed that ‘government failures’ outweigh market failures. But there are sufficient examples of successful government policies – for example, land reform in Taiwan and Korea, anti-poverty programmes in Botswana, Sri Lanka and Costa Rica, and industrial policies in Japan, Korea and Taiwan – to refute the view that government failures invariably outweigh market failures.

The other types of market failure are more difficult to handle, since they are so pervasive. Imperfect information is unavoidable, as are incomplete markets. The Arrow Debreu competitive equilibrium requires comprehensive perfect information and complete markets. These are impossible to envisage or bring about, since they include knowledge about, and markets relating to, all possible future states. In the absence of such perfect information, all activities have externality-like effects on others. The theoretical foundations for a market-led optimum are then undermined. Asymmetric information is particularly pernicious in markets where information is vital – for example, credit and insurance. Appropriate action to offset this pervasive imperfection is difficult to determine and varies according to the particular market. In general, government regulation to prevent ‘bad apples’ spoiling the market, to enforce contracts, to improve information and to reduce transaction costs is desirable.

Finally, undeveloped institutions can be an important source of market failure. North (1990) has noted that institutions (defined as rules, norms and conventions) played a key role in economic development historically. Subse-

quently, the related concept of 'social capital' has gained wide acceptance as an important economic input in addition to the more conventional ones of capital, labour and technology. Institutions, or social capital, frame the way the market (and government) operates. Market efficiency, then, depends in part on the prior development of institutions.

Institutions influence all activities. In modern economies, the norms, rules and laws are so well established that they are taken for granted. For example, it is assumed that if money is deposited in a bank it will be available for use later, or that a soft drink bought from a shop will not contain a dead mouse. Yet these depend on the existence of a complex institutional framework which may not be present in many places, especially in developing and transition economies. If a 'market' is introduced without adequate institutions in place, it is likely to be hijacked into short-term (perhaps criminal) activities, destroying much prior activity without replacing it by new production. It follows that policy needs to consider how to promote social capital. Yet appropriate government intervention is not easy to identify, is likely to be society-specific and is likely to take a long time to realize.

The existence of market failures, which are liable to be especially large and pervasive in developing countries, means that carefully designed, society-specific government activity is essential if the market is to produce a fair and efficient outcome. However, interventions should be designed so as to limit the probable magnitude of government failures.

See also:

welfare economics

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FRANCES STEWART

market power

'Market power' is the power to set prices well above the competitive equilibrium price (that is, marginal cost) without fearing the consequences of free competition. The market power of a firm in a particular industry is directly interrelated with the control that firm exercises on the price and the output in that industry.

Under the model of PERFECT COMPETITION, the firms are price-takers, but in most real markets there are firms with such a share of market power that they can influence both price and output. According to economic theory, these firms are not facing a flat demand curve described in the models of perfect competition (where, if they tried to raise their price above the equilibrium level, they would lose all their customers, and if they tried to lower their price, they would sell below their cost). Instead, firms with a substantial share of market power face a downward-sloping demand curve (they can raise the price up to the point at which marginal revenue equals marginal cost).

The greater the market power of a firm, the greater is its ability to raise the price costlessly. However, for a firm to use its market power to its fullest extent, there must be no close substitutes for its product (more generally, the demand curve must be inelastic) and its competitors must not be able to bid down prices (for example, because of ECONOMIES OF SCALE).

A firm with significant market power, by influencing the price and consequently the output of the industry, earns positive economic

market socialism

profits in the long run. A buyer could also have market power, thus influencing price and output (especially in cases of MONOPSONY or bilateral monopoly). The buyer then confronts an upward-sloping supply curve and their decisions determine the price. The price would then be lower than the price in perfect competition, and the buyer would also gain positive economic profits.

The existence of firms with market power in an industry inevitably leads to WELFARE losses. Furthermore, the absence of (perfect) competition guides the firms to behave inefficiently. Since there can be no market power in perfect competition, the existence of market power denotes IMPERFECT COMPETITION or even MONOPOLY.

However, a number of studies have shown that a great share of the market (or concentration) does not necessarily lead to prices above the competitive level. According to these studies, some firms have managed to grow because they are efficient; besides, their share of the market is always temporary, since there is a tendency for all firms that have a great share of the market to decline over time. The degree of concentration is surely an indication of possible inefficiency, but only if accompanied by the evidence of collusive behaviour, barriers against new competition or conspicuously super-normal profits, not attributed to superior EFFICIENCY.

A characteristic example is the case of MICROSOFT, which has managed to capture an enormous chunk of the software market. The essence of the controversy over Microsoft lies in the origins and nature of this tremendous market power. Is it the result of greater efficiency or of anti-competitive practices? It seems that it is both.

See also:

competition, economic role of; competition and government policy

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ARISTIDES N. HATZIS

market socialism

At its simplest, 'market socialism' describes an economic and political system that combines social ownership of the economy with the continuing allocation of COMMODITIES (including labour) through the mechanism of markets. Although traditionally SOCIALISM and the market have been seen as antithetical principles, almost all *practical* experience of socialism has entailed the use of markets. The evolution of a distinctive account of *market* socialism, however, is more specifically a product of that twentieth-century era in which there were real-world PLANNED ECONOMIES (and their problems) with which to contrast it. Nuti (1992) attributes the first usage of *Marktsozialismus* to Eduard Heimann in 1922, but its origins are most widely identified with the work of the Polish economist Oskar Lange and a number of like-minded theorists (including Abba Lerner) in the inter-war period.

Lange's model of market socialism was itself a response to a challenge mounted in the formative years of the Soviet Union by the Austrian political economist Ludwig von Mises. Von Mises challenged the possibility of rational economic decision-making under socialism (Mises, 1935). Rational economic calculation under socialism would be impossible,

he argued, because where there was no free market, there could be no pricing mechanism, and where there were no prices, there could be no economic calculation. The essence of Lange's reply was to insist that rational economic activity was indeed possible under socialism, because the state's Central Planning Board could act as a surrogate for the market by setting prices (and the institutional context for socialist enterprises) and then adjusting these prices through a repeated 'trial-and-error' procedure, so as to respond to fluctuation in supply and demand (Lange and Taylor, 1938).

Although there is no universally endorsed judgement on Lange's model of market socialism, many analysts have followed the position outlined by Abram Bergson (1966, 1967). His view was that while *technically* Lange's argument represented a successful reply to von Mises' criticisms of the economic irrationality of socialism, there were other aspects of the market (such as the promotion of motivation and innovation) which only *real* markets could secure. A revival of interest in this debate in the 1980s saw a still more critical judgement of Lange's position. In an influential study, Don Lavoie (1985) argued that, while the Langean scheme was almost 'unanswerable' as a simulation of the price-setting process as it was described in neo-classical economics, the AUSTRIAN SCHOOL of economics, to which von Mises belonged, also rejected this equilibrium theory of the neo-classicists as static and unrealistic. In practice, the market did not just disclose equilibrium prices. Indeed, it was the existence of DISEQUILIBRIUM in the market, and the possibility of profiting from it, that called forth entrepreneurial innovation and sponsored economic dynamism. Even more importantly, the market was 'a procedure for the discovery and conveyance of inarticulate knowledge', and this was a function that a socialist market, even one that built in managerial and entrepreneurial incentives, could not fulfil.

In proffering a model of market socialism that would allow rational resource-allocation under public ownership, Lange was not concerned with limiting the powers of the (one-

party) state. Yet the political context of one-party communist rule is quite central to understanding the way in which the theory of market socialism developed. Many of the most distinguished advocates of market socialism were Eastern European economists (including Brus in Poland, Kornai in Hungary and Sik in Czechoslovakia) and much of their advocacy was focused on the internal reform of existing communist regimes. In general, the leadership of the Communist Parties wanted economic improvement without political reform. Yet, in practice even more than in theory, the absence of accompanying political reform tended to undermine the possibility of effective economic reform. Even in those countries (such as Hungary and Yugoslavia) in which economic reform was most 'successful', efficiency and growth were constantly compromised by a largely unreformed political system.

In the East, tentative experiments with market socialism were overwhelmed by the inauguration of a fairly full-blooded market capitalism in the wake of the transformation of 1989. Previous advocates of market socialism now came out quite explicitly in favour of an economy based on the private ownership and exchange of commodities. Ironically, at much the same time, there was a revival of interest in market socialism among a number of Western political economists and political theorists (including Alec Nove, David Miller and John Roemer). Facing the seeming ubiquity of markets and the increasing difficulties of conventional forms of both socialism and SOCIAL DEMOCRACY, these theorists found a radical alternative in a social formation that combined markets with social ownership. Market socialism recommended itself to them not only as a way of attaining greater economic EFFICIENCY under social ownership, but also as a way of securing greater individual liberty or a more equal value of liberty, of increasing democracy and of enhancing social JUSTICE. Despite a brief flurry of interest among the architects of social democracy's 'programmatic renewal' (and its claims to enhanced 'feasibility' notwithstanding), market socialism has proven rather too radical for those parties of

markets as institutions

the Left and centre-Left which have come to office in the West. The willingness to embrace markets is widely endorsed, the aspiration to combine them with social ownership of capital much less so.

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CHRISTOPHER PIERSON

MARKET-ORIENTED REFORMS see neo-liberalism

markets as institutions

Many economists incline towards pro-market policy solutions to economic problems. It is perhaps strange, therefore, that the market is infrequently defined in economics textbooks, and its institutional relations and properties are rarely explored. There is an explanation for this, however. Many economists regard the market as a kind of primary and institution-free ether of individual interaction and exchange. It is believed that when people gather together in the name of trade, then a market somehow always emerges in the midst of them. As two authors of a well-established economics

textbook put it: 'a market exists whenever two or more individuals are prepared to enter into an exchange transaction, regardless of time or place' (Gravelle and Rees, 1992: 3). As Viviana Zelizer (1993: 193) pointed out, this problem is not confined to economists. While economists use the term 'market' widely and loosely, sociologists have become obsessed with the cash nexus, with the vision of an ever-expanding market inevitably dissolving all social relations and corrupting culture and personal values. Mesmerized by this vision of inexorable force, sociologists implicitly adopted an extremely simple conception of the process, making it resemble the sweeping away of landmarks by a giant flood. That left unaddressed the crucial question: How do real markets work? Markets were seldom studied as social and cultural arrangements. For if the modern market has indeed neutralized social relations and homogenized cultural distinctions, there is nothing much left for sociologists to study. Thus the market was surrendered to economists.

However, economists have had little to say about the nature of markets, other than classifying them by their degrees of competition, largely according to the number of buyers or sellers they contain. The institutional aspects of markets are widely neglected. Here we focus on the basic theoretical problems of this stance and leave the discussion of the policy issues on one side. Nevertheless, the theoretical discussion should prompt a questioning of some established policy positions.

Before we ask what is a market, it is appropriate to examine one of its essential components: exchange. The sense in which exchange is understood in the specific context of business and trade is something more narrow than that in the general notion of 'exchange theory' in sociology (Blau, 1964; Homans, 1961). By using 'exchange' in an economic or commercial sense, we generally mean something more than (say) the reciprocation of a polite greeting, a wave or a smile. As the institutional economist John Commons (1924) insisted, exchange proper involves the contractual interchange of PROPERTY RIGHTS in return for goods and services. Unless a

transfer of property rights is involved, it is not properly described as exchange.

We find immediately a problem in the mainstream approach and in the – literal or illustrative – idea that ‘in the beginning there were markets’ (Williamson, 1975: 20). Concerned to build its analysis on atomistic individuals that somehow interact in an institution-free environment, it fails not only to consider the institutional form of the market, but also the institutional bases of even more general forms of economic interaction. Exchange, in the sense of Commons and others, requires, first, a common system of language or, at least, mutually understood signs, so that the individuals involved can communicate. Second, an enforceable set of rules or laws must govern the contracts between individuals. Third, there must also be a system of established property rights to make property transfers meaningful and enforceable.

In most accounts it is accepted that some of these rules and laws can emerge gradually over time and possibly – at least in the case of language – without intention or design. The degree to which the state or other powerful organizations have been involved in these processes is a matter of important analytical controversy, but it need not concern us here. The key point is to notice that all these frameworks are, in an established sense of the word, *institutions*.

Institutions can be defined as relatively enduring structures, rules and patterns of social behaviour, of ‘some prevalence and permanence’ that ‘fix the confines of and impose form upon the activities of human beings’ (Hamilton, 1932: 84). They depend on the thoughts and activities of individuals, but are not reducible to them. Accordingly, exchange requires an institutional bedrock before it can take place.

A case can be made that there is something different between exchange, as such, and market exchange (Hodgson, 1988). There is something quite specific to markets that is not common to all forms of exchange. As George Richardson (1972) pointed out in a classic essay, many exchange transactions between

firms are not trades in the open market but contracts between firms and suppliers that have longstanding and close organizational relations with each other. These longstanding ties promote TRUST relations and establish mechanisms for dealing with difficult and uncertain matters such as quality control. What is described in the literature as ‘relational exchange’ (Goldberg, 1980) is quite different from the more competitive transacting of the open market. SPOT MARKET exchange may provide more price competition, but when the nature or quality of the products is uncertain then we can never quite be sure what we are buying. By definition, exchange need not occur on markets, although a market always involves exchange.

What, then, is a market? Examples of a market include a stock exchange or the more traditional town market situated in an open square or a building. What these have in common is a degree of organization and regulation. Markets of this type may have emerged gradually and without a single, overall plan. Nevertheless, clear organizational features are apparent. For instance, there are rules governing who may trade and the interactions between traders. Often the right to sell on such a market is regulated. Typically, both formal and informal rules govern such procedures as negotiation and price-setting. Many of these rules are culturally specific. For instance, in Japan, haggling over prices is uncommon and perceived as an insulting challenge to the seller and to the worth and quality of the goods being offered. By contrast, in markets in North Africa and the Middle East bargaining is seen as normal and protracted to the point of establishing some kind of personal relationship between buyer and seller.

An important organizational function of modern financial markets, in addition to setting down rules for the who and the how of buying and selling, is the screening and filtering of information. Millions of transactions take place on modern financial markets and it is impossible for traders to monitor all this information. Accordingly, they make do with selective, published financial indexes such

as the FTSE or the Dow Jones. Furthermore, extensive use is made within markets of established networks between traders. In his path-breaking empirical study of financial markets, Wayne Baker argued that: 'Trading among actors exhibited social structural patterns that dramatically affected the direction and magnitude of option price volatility' (Baker, 1984: 775).

Markets are institutions in the sense that they are relatively enduring structures and patterns of social behaviour, of 'some prevalence and permanence' that 'fix the confines of and impose form upon the activities of human beings' (op. cit.). A market is an institution in which a significant number of commodities of a particular type are regularly exchanged and in which the rules and structures relating to the market pattern these exchange negotiations and transactions. More generally, exchange involves contractual agreement and the exchange of property rights. Markets, where they exist, help to structure, organize and legitimate exchange transactions. They involve pricing and trading procedures that help to establish a consensus over prices, and often help by communicating information regarding products, prices, quantities, potential buyers or possible sellers. Markets, in short, are organized and institutionalized exchange.

In some cases, it is difficult to draw a distinction between a market and a non-market. However, this should not necessarily lead us to abandon the distinction. Taxonomic problems are ubiquitous with complex and varied phenomena. (Is the duck-billed platypus a mammal?) Accordingly, the existence of such problems does not mean that we should ignore such attempts to classify and group into classes.

Consider an example. If we can order items on the internet, is it then a market? This is possibly a borderline case, but even so there are rules and protocols concerning the use of the internet for exchange. Furthermore, there are internet services that offer help by comparing and assessing prices and other relevant information. It is thus quite reasonable to regard the internet as containing markets, albeit with a

typical degree of organization lower than that found in other markets. Another example of a market close to the taxonomic border is the postcard 'for sale' or 'help wanted' signs in the local shop or supermarket.

The institutional character of markets has been recognized by German historical economists (see HISTORICAL SCHOOL, GERMAN) in the nineteenth century and by institutional economists such as Commons and J.A. HOBSON. Long ago, Hobson wrote: 'A market, however crudely formed, is a social institution' (Hobson, 1902: 144). However, these insights have subsequently been dismissed or neglected by most mainstream economists.

Different types of market institution are possible, involving different routines, pricing procedures and so on. Even some mainstream economists have begun to notice this. As experimental economics has emerged as a major subdiscipline, it has been realized that the simulation of market phenomena necessarily involves the setting out of specific rules and procedures. Modern experimental economists, in simulating markets, have found that they have also had to face the unavoidable problem of setting up their institutional structures. As leading experimental economist Vernon Smith wrote: 'it is not possible to design a resource allocation experiment without designing an institution in all its detail' (Smith, 1982: 923).

Furthermore, each particular market is entwined with other institutions and a particular social culture. Accordingly, there is not just one type or set of markets – perhaps differentiated merely by the type and degree of market structure and competition according to textbook typology – but many different markets, each depending on its cultural and institutional context. Among others, Werner Sombart, the leading German Historical School economist, recognized this vital point. He argued that the concept of exchange depended for its meaning on the social and historical context in which the exchange takes place:

'Exchange' in the primitive economy (silent barter), 'exchange' in the handicraft economy and 'exchange' in the capitalist economy are

things enormously different from one another. Price formation in the fair at Vera Cruz in the seventeenth century and in the wheat market on the Chicago Exchange in 1930 are two altogether incomparable occurrences (Sombart, 1930: 211, 305).

This statement is an important corrective to the notion of a pure and undifferentiated market that is promoted by both its critics and its supporters. The recognition that (1) the market is an institution and (2) different, institutionally differentiated types of market may exist, has important theoretical and policy implications.

In conclusion, the market itself is not a natural datum or ether, but is itself a social institution, governed by sets of rules defining restrictions on some, and legitimating other, behaviours. Furthermore, the market is necessarily embedded in other social institutions, such as in some cases the state. It can emerge spontaneously, but it can also be promoted or even in some cases created by conscious design.

This affects policy stances of both the Right and the Left. The Rightist advocacy of 'free' markets becomes problematic once it is realized that all markets are institutions, that all institutions (by promoting rules) constrain as well as enable, and that there is no single ideal or 'free' type of market to favour. From the opposite political position, Leftists sometimes dismiss all markets because of their alleged capacity to promote acquisitiveness and inequality. Yet, once it is realized that there are different types of market, with very different cultural integuments and social outcomes, then the blanket dismissal of all markets becomes as problematic as its Rightist obverse. Both the Left and the Right commit the similar error of regarding all markets as essentially similar, ignoring their institutional differences and varied outcomes.

See also:

atomism; institutionalism; evolutionary economics; law, economic role of

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GEOFFREY M. HODGSON

markets, primary

The primary market is the market where newly issued FINANCIAL INSTRUMENTS, shares, BONDS, DERIVATIVES and so on, are placed in the first instance. In this market, the issuer (the government), companies or other bodies and institutions can sell new financial instruments to buyers and raise cash. There is a direct relationship between the issuer of the financial asset and the investor or user of the instrument itself. Once the instrument has been issued and placed in the primary market, it can then be traded in secondary markets.

L.S. TALANI

Marshall, Alfred (1842–1924)

Alfred Marshall began investigating INTERNATIONAL TRADE in the early 1870s, yet his main contribution, consisting of his detailed exploration and extension of JOHN STUART MILL (1920) using 'reciprocal demand' or 'offer curves', was not published until fifty years later in 1923. Parts of an early draft were printed for private circulation by Sidgwick in 1879, but Marshall was ill at the time and played no part in their selection. Marshall referred to some of that early work as belonging 'to the economic toy shop rather than practical work shop' (Marshall, 1975: vol. 2, p. 4). The diagrams became better known through their use by Pantaleoni (1898) and Edgeworth (1894). However, in his earlier studies (Marshall, 1975: vol. 2, pp. 246–8), Marshall cast Cournot's (1927) model into diagrammatic form, mainly for the purpose of examining the gains from trade using measures of producers' and consumers' surplus, which he showed using the now familiar triangles (on this model, see Creedy, 1992).

The diagrammatic version was later refined by Marshall's student Cunyngame (1892, 1903), who suggested that 'the method of treating economics graphically is probably due to Cournot' and added, 'the chief credit of reviving an interest in this method rests with Professor Marshall' (Cunyngame, 1892: 36).

In his first published paper, Marshall (1925 [1876]) indicated his preference for the general approach of Mill rather than Cournot; he wrote to Cunyngame that, 'as to international trade curves – mine were set to a definite tune, that called by Mill' (Pigou, 1925: 451), and when writing to J.B. Clark in 1908, Marshall stated that during the four years after 1870, 'I worked a good deal at ... the diagrammatic treatment of Mill's problem of international values' (ibid.: 416–18). Marshall rejected the use of simple partial equilibrium schedules involving money prices because of the complex interdependences between the various schedules. He argued that

students frequently fall into errors which they may easily avoid if they will resolve that when discussing the pure theory [of foreign trade] they will not speak of the imports or exports of a country as measured in terms of money.

(Marshall, 1975: vol. 2, p. 131)

Marshall did not provide any statement of how he arrived at these curves, but it is of interest to compare Marshall's attempt (ibid.: vol. 1, pp. 260–80) with the later analysis (ibid.: vol. 2, pp. 117–81) and finally with the mature version (Marshall, 1923: 330–60). He began in each case with offer curves for each country that are elastic over the whole length shown and then discussed their possible shapes in terms of elasticities. In the earliest essay, Marshall used the clumsy expression 'guidance by the rate' for 'elasticity', but by 1923 the analysis was clearly stated in terms of elasticities and included a footnote giving a neat geometrical method for finding the elasticity (ibid.: 337, note 1). He also provided a method for deriving consumers' surplus from the offer curves (see Creedy, 1990; 1991). A distinguishing feature of Marshall's analysis of offer

curves was that he also had variations in production in mind, rather than an exchange of fixed stocks; such variations were clarified by the later detailed treatment by Meade (1952).

Marshall's recognition of the possibility of his offer curves intersecting more than once and the circumstances under which such multiple equilibria can occur, led him to devote much energy to dynamic adjustment problems and the question of which of several equilibria would be stable. Instead of presenting the mathematics of differential equations, Marshall applied (for the first time in economics) the phase-diagram method. Marshall was sceptical about the use of mathematics to examine dynamic problems. Even if the equations of the offer curves were known precisely, he argued 'the methods of mathematical analysis will not be able to afford any considerable assistance in the task of determining the motion of the exchange-index' (Marshall, 1975: vol. 2, p. 163). (On dynamics, see Samuelson, 1948: 266-9; Bhagwati and Johnson, 1960; Amano, 1968.)

Marshall came to regard his offer-curve apparatus as capable of

being translated into terms of any sort of bargains between two bodies, neither of whom is subject to any external competition in regard to those particular bargains.

(Marshall, 1923: 351)

A major context was that of bargaining between firms and trade unions, but it was left to Edgeworth to extend the analysis to those other areas.

Marshall can also be seen at an early stage struggling with the problem of 'triangular barter'. In Marshall (1975: vol. 2, pp. 272-4), he used demand curves specified in terms of relative prices (rather than offer curves) to examine the situation in which Germany exchanges linen for cloth, England exchanges cloth for fur, while Russia exchanges fur for linen. Marshall's problem was very similar to the three-country case considered by J.S. Mill, and Marshall's approach closely followed Mill, who suggested:

everything will take place precisely as if the third country had bought German produce with her own goods, and offered that produce to England in exchange for hers.

(Mill, 1920: 592)

Marshall became 'rather tired' of his curves, explaining to Cunyngame that

I had followed Mill in taking a yard of cloth as representative of England's exports and Germany's imports: which I still think is right. But then I had glided, as he had done, unconsciously into regarding the demand for imports in general as having a similar character to that for a single commodity. And I now think that is illegitimate, and vitiates a great part of my curves.

(Pigou, 1925: 449-50)

Nevertheless, as Edgeworth commented, 'there is more than meets the eye in Professor Marshall's foreign trade curves' (1905: 70). This comment, which could be applied to the majority of Marshall's published work, goes some way towards explaining why he continues to be studied with profit by economists.

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JOHN CREEDY

Marshall Plan

The Marshall Plan was a major programme of economic aid from the United States to western Europe, announced by Secretary of State George Marshall in 1947 and completed in December 1951. The European Recovery

Program (ERP), as the plan was formally known, had both economic and political objectives. Its chief goal was the economic reconstruction of Europe after World War II's devastation. By improving living conditions in western Europe, US policy-makers also hoped to lessen the chance of communist victories in local elections, then considered a real possibility in France and Italy. The ERP also had a broader strategic aim: to forge a strong, stable Atlantic alliance for the deepening COLD WAR with the Soviet Union. For the United States, this meant encouraging cooperation among west European states and, most importantly, integrating the western sectors of Germany into a stable political-economic framework. The Marshall Plan did all this by providing approximately US\$13 billion in aid to a newly constructed consortium of European states, requiring them to work together to distribute the funds and to cooperate over trade, money and investment issues. The Marshall Plan was extraordinarily successful in all its central goals. It played a critical role in helping west Europeans rebuild their economies on an integrated, non-communist basis.

CHARLES LIPSON

Marshall–Lerner condition

The Marshall–Lerner condition expresses the circumstances under which a devaluation will improve a country's trade balance of goods or goods and services, when trade is initially balanced. In its most general form, the condition is expressed algebraically as a function of a country's price elasticities of supply of exports and imports and the absolute value of the price elasticities of demand for exports and imports (see PRICE ELASTICITY). If this expression is positive, the trade balance will improve. However, two special cases of this general condition have attracted most attention. The first, which is sometimes referred to as *the Marshall–Lerner condition*, is where the price elasticities of the supply of exports and imports are infinite. In these circumstances, the condition

for a successful devaluation is that the absolute value of the sum of the price elasticities of demand for exports and imports are greater than unity. The second case is of a small country that faces an infinitely elastic foreign demand for its exports as well as supply of its imports. The condition now becomes: the sum of the elasticity of supply of exports and the elasticity of demand for imports must be positive. If this is met, the trade balance must necessarily improve.

J.S.L. McCOMBIE

Marx, Karl Heinrich (1818–83)

Karl Marx was a highly influential German thinker and revolutionary who began in the philosophical tradition of G.W.F. Hegel, but turned to POLITICAL ECONOMY to develop his system of thought. Marx's most famous work was *Capital: A Critique of Political Economy*, the first volume of which was published in 1867. He was the theorist of a variety of revolutionary SOCIALISM that did much to shape the history and politics of the twentieth century in many parts of the world, but the influence of Marxism (see MARXISM–LENINISM) in terms of organizational politics has declined substantially after the collapse of the USSR in 1991. The precise relationship between Marx and his many followers, such as V.I. LENIN who founded the Soviet Union, is a topic of much controversy.

In the field of philosophy, Marx proposed the idea of 'species-being' as essential to human nature and claimed to uncover the 'rational kernel' of Hegel's method. In the field of economic theory, Marx developed the LABOUR THEORY OF VALUE into a theory of EXPLOITATION and proposed a controversial law of the tendency of the rate of profit to fall (see FALLING RATE OF PROFIT (FRP)). In the field of history, Marx created the materialist conception of history and authored an influential description of the genesis of CAPITALISM in Great Britain. In the field of politics, Marx advocated the abolition of both private prop-

erty and class divisions, to be achieved through a political revolution. In the field of international development, Marx analysed capitalism as being composed of imperial centres and colonial outposts, and portrayed capitalism as sweeping relentlessly across the globe. In the field of international economics, Marx suggested that dominant states determined trade relations and provided insights into how capitalism generated global crises. In all these areas, Marx's ideas have been influential, but the precise meaning of them has been subject to much debate.

Intellectual development

Marx was born in the Rhineland region of Germany from Jewish parents. He studied philosophy, literature and law at the Universities of Bonn and Berlin, and subsequently wrote a doctoral thesis on Greek philosophy. During an illness, Marx was converted to Hegelianism and became an important member of the left-wing Young Hegelian movement. In the early 1840s, he wrote many journalistic pieces on contemporary affairs for the *Rheinische Zeitung* but, after its suppression by the Prussian government, Marx moved to Paris, where he wrote a key work called the 'Economic and philosophical manuscripts' of 1844. Of importance to the understanding of Marx's conversion to COMMUNISM is the concept of 'species-being' proposed in this work.

It was in Paris that Marx first met Friedrich Engels, who was to become his lifelong friend and collaborator; it was Engels who published the second and third volumes of *Capital* after Marx's death. Engels was the author of *The Condition of the Working Class in England* of 1844 – an attack on the poverty-stricken environment of early capitalism – but ironically the Engels family were factory owners themselves. It was in part Engels' financial security that allowed Marx to concentrate on intellectual matters. Their first major collaboration was *The German Ideology* of 1846, but their most influential joint work was *The Communist Manifesto*, first published in 1848. This gave a sequential history of human society in four

stages – primitive communism, slavery, FEUDALISM and capitalism – and described the role of communists as leaders of the burgeoning proletarian movement. Section I began with the famous phrase: ‘The history of all hitherto existing society is the history of CLASS STRUGGLES ...’ – free person and slave, lord and serf, capitalist and worker – and identified the proletariat as the only class capable of moving society onwards. The *Manifesto* was not an abstract document but one closely connected to the context of revolutionary activity that swept across Europe in 1847–9.

After this revolutionary surge had waned, Marx moved first to Brussels and then to London, where he would spend the rest of his life. He resumed his economic work by spending long periods in the British Museum studying theoretical and statistical material on the domestic and overseas history of British capitalism, which eventually yielded *Capital* and the *Theories of Surplus Value*. In economic theory, Marx respected the views of ADAM SMITH and DAVID RICARDO, but thought that later writers such as J.R. McCulloch were ‘vulgar apologists’ for the capitalist system. The result of Marx’s economic studies in the 1850s was the *Grundrisse* of 1857–8, which contained preliminary studies for *Capital*. However, it is important to be clear about the relationship between Marx’s original intentions in his economic work and the actual published outcome.

Marx’s original project was to write a multi-volume ‘Critique of political economy’ or critique of economic categories (such as value, exchange, capital and labour), fashioned from the content of existing works in this field (such as *Principles of Political Economy* by J.S. MILL) but using an interpretation of the method of Hegel’s *Science of Logic*. What was published as *Capital* was only the first part of Marx’s original scheme, which had six parts: (1) on CAPITAL, (2) on landed property, (3) on wage labour, (4) on the STATE, (5) on international trade and (6) on the world market. The various parts of Marx’s project were intended to form an interconnected whole, of which the conclusion would lead back to the point of

origin and each component would develop naturally from the one before. In the *Grundrisse*, the Hegelian roots of Marx’s economics were more visible than in *Capital*. For example, capital was described as the ‘immediate unity’ of production and circulation, and was shown creating and surmounting boundaries which were contained within itself.

In the early 1860s, Marx worked in earnest on *Capital*, the first volume of which appeared (in German) in 1867 with terminology less Hegelian than the *Grundrisse*. It contained both a theoretical analysis of some of the categories of capitalist production and historical material on the genesis of capitalism, in particular the process of primary capitalist accumulation. Marx outlined that capitalism had developed in Britain by expropriating masses of agricultural producers from the soil and forcing them as proletarians onto the labour market; once capital accumulation began, it became a systemic compulsion. However, Volume 1 left some theoretical questions (such as the transformation of labour values into prices) unanswered and further volumes of Marx’s *magnum opus* were eagerly awaited by fellow socialists. By this time, Marx had abandoned his original idea for a six-part ‘Critique’ in favour of a three-part treatment of ‘capital’ alone.

In parallel with his economic studies, Marx took a leading role in founding the First International Working Men’s Association in 1864. This body was devoted to promoting the interests of the working class (see CLASS, WORKING), but it was a different type of organization to that of the revolutionary party to which Marx’s name would later be attached. The First International reached the height of its influence in 1867–9, but was formally dissolved in 1876. In the 1870s, Marx also worked on various translations of the first volume of *Capital*, the first being a Russian edition of 1872. Following this, a dispute arose within Russian Marxism about whether Marx’s account of the stages of societal development could be applied to Russia or was confined to Western Europe alone; Marx was somewhat equivocal on the issue.

In the late 1870s, Marx became increasingly occupied with studying the agrarian history of Russia, for which he learnt to read Russian. This interest delayed work on *Capital*, but Marx saw it as essential to completing his research. He kept the true state of the manuscripts of Volumes 2 and 3 a secret even from Engels, who was surprised to discover the lack of progress that had been made by the time of Marx's death in 1883. Marx had been slowed by some newly discovered facts that did not fit his pre-established scheme, and by failing health and polemical disputes with other socialists. Engels made no attempt to incorporate the new Russian material on which Marx had been working into Volumes 2 and 3, seeing them as a distraction, and published the drafts that Marx had written as complete texts.

Volume 2 of *Capital* contained a detailed analysis of the circulation process of capital, while Volume 3 included discussion of economic crises, an analysis of ground rent and a solution to the transformation problem. However, the fact that Marx had not completed his plan for a six-part 'Critique of political economy' was quietly ignored by Engels and many others. The three volumes of *Capital* constituted only the first of the six sections of Marx's original scheme: thus Part V, on international trade, and Part VI, on the world market, remained unwritten and Marx's views on the international development of capitalism were never systematically elaborated or presented.

Philosophy

Marx was thoroughly immersed in the long tradition of German philosophy of which Hegel was seen as the culmination. Hegel's famous dialectical method involved the comprehension of the unity of opposites in triadic progression: for example the proposition that the unity of 'being' and 'nothing' was 'becoming' – or thesis, antithesis, synthesis. While it is a matter of dispute how far the 'mature' Marx used Hegel's method, it was unquestionably the background against which he developed his thought. In the early 1840s, Marx began to

apply his interpretation of the Hegelian method to areas outside philosophy – for example, to law and economics. In the 'Economic and philosophical manuscripts', Marx analysed how the DIVISION OF LABOUR that capitalism promoted led to workers being alienated from their true nature or from their 'species-being'. This was the species nature of human beings, their social character and their need to express themselves artistically and emotionally through work.

In capitalism, workers were alienated from the products of their labour, which were objectified externally in private property and capital. Using Hegel's method, Marx opposed 'labour' and 'capital' as the first two elements of a triadic progression and demonstrated how they were at first united in primitive forms of communism, then separated and estranged under capitalism. Their final reunification would occur only under a new economic order – communism – where property would be owned collectively. Marx painted a picture of future communist society as idyllic, with people being given the opportunity to develop all aspects of their artistic and emotional potential. It was this initial vision of communism as utopia that motivated Marx to engage in the agitation designed to achieve communism in reality.

Economic theory

Marx analysed capital as being composed from two elements: constant and variable capital. Constant capital (c) was capital expended on buildings, machinery, raw materials and energy; variable capital (v) was that spent on the wages of workers. Wages were determined by the labour required to produce the means of subsistence for workers. The ratio of constant against constant plus variable capital – $c/(c+v)$ – was the organic composition of capital. Marx assumed that capitalism generated a tendency for the organic composition of capital to increase over time, which meant that workers were being replaced by machines.

Like the classical economists, Marx founded his analysis on the LABOUR THEORY OF VALUE.

As formulated in Volume 1 of *Capital*, this asserted that the exchange value of a commodity was determined by the amount of socially necessary labour embodied in it. 'Socially necessary' meant labour time under normal conditions of production and with average skill and intensity. The admitted fact that not all commodities were actually exchanged at their labour value led Marx in Volume 3 of *Capital* to distinguish between labour embodied, price of production and market price, moving between these concepts being the famous transformation problem. The problem arose because the organic composition of capital varied in different branches of industry, which meant that profit rates would also differ if market prices equalled values, something that was plainly unrealistic. Marx's solution was to suggest that prices deviated from values so as to equalize the rate of profit across industrial branches. Even some socialists were disappointed by this solution and errors in Marx's presentation were later detected.

Marx also introduced into economics the concept of SURPLUS VALUE, which he believed was his most important contribution. Put simply, surplus value was that amount of labour power which the worker *was not* paid for. Suppose that a worker worked an eight-hour day and for this was paid £25. Marx believed that, in fact, the worker's labour power that day was worth more than £25, say £30, but that a £5 surplus was being extracted that formed the revenue of the employing capitalist. The value of any commodity was thus composed of three elements: the amount of constant and variable capital necessary for its production, plus the amount of surplus value (*s*) taken by capitalists:

$$c + v + s$$

Marx defined the rate of surplus value as the ratio of surplus value to variable capital – s/v – and the rate of profit as the ratio of surplus value to variable plus constant capital – $s/(c + v)$. Some have argued that Marx confused the notion that the productive process produced a surplus with the idea that this was attributable to labour factors alone.

Following on from this, as Marx believed that the organic composition of capital increased over time, this meant that the rate of profit must fall, since surplus value could only be extracted from variable capital (expended on labour) not constant capital. In other words, the rate of profit varied inversely with the organic composition of capital. In this 'law of the tendency of the rate of profit to fall', Marx believed that he had discovered one of the basic contradictions of capitalism that guaranteed it would collapse and be superseded by socialism. He accepted that various counteracting causes could temporarily offset this law (such as raising the intensity of exploitation or cheapening the value of constant capital) but implied that the logic of this law would eventually prevail. This process also led to the formation of a reserve army of unemployed due to the labour-saving bias of technical change: the amount of unemployment grew as capital accumulation proceeded. Some have raised doubts about the form of Marx's law – a basic tendency with counteracting causes – since it is always possible to argue that counteracting causes outweighed the basic tendency in any specific period.

Another of Marx's inventions were the reproduction schemes used in Volume 2 of *Capital* to analyse the relation between industrial branches. Marx divided industry into two sectors. Department 1 produced means of production; Department 2 produced means of consumption:

$$(1)c_1 + v_1 + s_1 \quad (2)c_2 + v_2 + s_2$$

Simple reproduction obtained when the constant capital used in both branches equalled the output of Department 1 and the consumption of capitalists and workers equalled the output of Department 2. Expanded reproduction occurred when capitalists invested part of their income in enlarging production. What was especially interesting about these schemes was that they produced specific equilibrium conditions for reproduction which, if violated, led to disequilibrium in the production process.

Marx had provided a framework that suggested how economic disturbances could arise in capitalism from disproportion between industrial branches (see DISPROPORTIONALITY).

Volume 2 also contained a painstaking exposition of the circulation of various forms of capital expressed in symbolic form – the circuit for money capital being:

$$M - C \dots P \dots C^1 - M^1$$

or

$$\begin{array}{c} \text{money} - \text{commodity} \dots \text{productive capital} \dots \\ \text{commodity} - \text{money} \end{array}$$

(with the latter two categories being augmented by surplus value).

Such circuits had both an analytical function, in explaining at what point surplus value was extracted, and a defining function, in suggesting the motive force behind international capitalist expansion. As with the reproduction schemes, Marx's circuits showed how capitalism was prone to periodic crises if the transformation of commodities into money during the circulation process was disrupted. Some have noted a difference between such a realization crisis and the disproportionality type of crisis suggested by the reproduction schemes. Overall, Marx's economic theory provided a number of different mechanisms which generated instability – declining profits, increasing unemployment, economic crises – and he proclaimed that, taken together, they foretold capitalism's eventual demise.

Theory of history

In the 'Preface to a critique of political economy' of 1859, Marx gave an account of his materialist conception of history. He proposed that two aspects of material life were crucial to understanding historical development – the forces and relations of production. The forces of production were both the material means of production or instruments of production and raw materials, as well as labour power. The relations of production were

the social relations between classes in the production process – the specific manner in which the surplus product was extracted. For Marx, the foundation of society was its 'economic base', on which were built superstructural phenomena such as legal and political institutions. The economic base 'determined' the SUPERSTRUCTURE of any given society and the combination of forces and relations of production defined any given MODE OF PRODUCTION.

Marx then revealed that the productive forces developed over time and that, at a certain stage of their development, the forces came into conflict with the existing relations of production. From forms of development of the productive forces, the relations became fetters on further development. This process ushered in a period of social revolution in which the relations were transformed in conformity with the new forces of production. Examples of the 'social revolution' between modes of production that Marx had in mind were the transition from slavery to feudalism, from feudalism to capitalism and from capitalism to communism. This explanation of historical development has proved fertile for historians and sociologists, but less so to economists.

However, immediately after it was proposed, problems with this model became apparent. How exactly did the economic base determine the superstructure? Through what mechanism did it achieve this? And if revolutions were the result of the interplay of such abstract forces, what was the role of the individual in this process? Did human thought simply reflect the productive forces? Such questions led Engels to propose that the economic base was determinant 'only in the last instance'; suggestions that the superstructure 'reacted back' on the base were equally elusive. And what constituted the economic base of society: the forces or the relations of production? Another problem was that this idea appeared universal in scope by suggesting that the development of all societies could be explained by the base/superstructure model. Marx realized this sometime later, protesting to a Russian Populist that 'he feels he absolutely must metamorphose my historical

sketch of the genesis of capitalism in Western Europe into a historico-philosophic theory of the general path every people is fated to tread' (McLellan, 1977: 572). In fact this ambiguity can be traced to Marx's own work.

The international development of capitalism

In their initial sketch of how capitalism developed (as given in the 1848 *Communist Manifesto*), Marx and Engels portrayed capitalism as a universalizing system, a mode of production that would sweep all other modes aside and by its own momentum encompass the entire world. The requirement for constantly expanding markets led the European ruling class to form links all over the globe, which led first to colonial dependence and then to the establishment of capitalism overseas. Foreign trade and the export of capital were methods which could be used to counteract the law of the tendency of the rate of profit to fall for a finite period. Capital invested in the colonies yielded a higher rate of profit than that invested domestically, on account of the lower organic composition of capital, the use of slave labour and the bounty of nature. The profits brought home entered into the equalization of the general rate of profit and counteracted the tendency to decline. Eventually, however, all overseas markets would become saturated once capital had reached its geographical limit and at this point capitalism could not escape its intrinsic laws of motion.

In the *Communist Manifesto*, the geographical expansion of capitalism was linked to the discovery of new countries and new markets (such as America and East India) by the European ruling class. Marx and Engels wrote:

The bourgeoisie has through its exploitation of the world market given a cosmopolitan character to production and consumption in every country ... All old established national industries have been destroyed ... In place of the old local and national seclusion

we have intercourse in every direction, universal interdependence of nations.

(ibid.: 224)

The cheap price of commodities was the 'heavy artillery' with which the bourgeoisie battered down all national barriers and compelled the universal introduction of the capitalist mode of production. However, the 1848 *Manifesto* was only an introductory sketch of this process, written for polemical purposes, and it was based on a simplistic understanding of non-capitalist forms of economy. A spectre of the *Manifesto's* portrayal of capitalism as universalizing would return to haunt Marx in his later work.

After 1848, Marx studied certain examples of capitalist expansion in more detail – these being India, China and Russia. In the case of India, Marx proposed that before British COLONIALISM, Indian society had been governed by the ASIATIC MODE OF PRODUCTION. This consisted of an authoritarian state in control of a multitude of small villages, the state extracting the surplus product through taxation for large-scale public works such as irrigation schemes. Within the village community, agriculture and handicrafts existed in parallel and communal ownership prevailed. However, the Asiatic mode of production was rather unique in that it was static – it had no internal history of its own and no intrinsic motive force of development. Asiatic society was resistant to capitalist competition, as producers controlled their own means of subsistence. For Marx, it was British imperialism that brought development to India through the destruction by force of Asiatic structures.

Various problems with this analysis of India can be highlighted. First, a mode of production with no internal dynamic seemed alien to Marx's general approach. Second, the idea that Asian society had no history of its own, that all change was brought about by invasion, was a rather Eurocentric view. While Marx admitted that colonial rule in India was exploitative, he appeared to be saying that it was progressive and that no domestically generated alternative

was possible. The concept of the Asiatic mode of production was not one of the stages of societal development found in the 1848 *Communist Manifesto*. However, in the 1859 'Preface to a critique', Marx placed it before slavery, feudalism and capitalism, implying that a modification to his analysis had occurred that allowed plurality of paths of development. Another problem can be detected in the idea that investment overseas yielded a higher rate of profit. Low wages might prevail in the colonies, but so also did low productivity of labour and hence higher costs of production. In the case of India, Marx admitted that the costs of occupation might exceed the returns, but failed to connect this with his general reasoning concerning capitalist expansion.

After the publication of Volume I of *Capital* in 1867, Marx turned his attention to forms of primitive communism, such as the peasant commune in Russia, which practised periodic redistribution of land. Marx was surprised that the peasant commune was not being swept away by the development of capitalism in Russia – instead it appeared to be co-existing alongside capitalist relations. Further study of village communities, such as those in Germany, led Marx to reconsider his view that international capitalist expansion led inevitably to the destruction of agrarian communes, which were now seen as more resilient. This shift had important implications for Marx's analysis, since he had previously assumed that such forms of economy would easily be swept aside by capitalism. It led Marx tentatively to suggest that the Russian commune could be the basis for by-passing capitalism in Russia and proceeding directly to socialism, if this was accompanied by a revolution in the West.

This was a significant change. If capitalism was not quite the universalizing economic system that Marx and Engels had hypothesized in the *Communist Manifesto*, then their recommendations for political struggle might have to change, as they were grounded in historical analysis. In fact, Marx never admitted that modifications to his views had occurred and his Russian disciples were left to act out the contradictions of his thought in their polemical

disputes. This modification hid another more fundamental change to Marx's approach. Initially, he had believed that no new mode of production appeared before the existing one had exhausted all its potential. Study of archaic economic formations led Marx to posit that a series of layers, with elements surviving from various ages, might co-exist, superimposed on each other. This complicated the straightforward 'stages' view of societal development on which the transition to socialism was predicated.

International economics

In the 1850s, Marx was one of the first economists to investigate the international propagation of economic disturbances, emphasizing that Britain was usually the epicentre of cyclical movements. As Britain was the central market for many continental countries, fluctuations in the British economy caused corresponding changes to the export prospects of continental goods. Conversely, glutted foreign markets aggravated crises which had originated in Britain – all countries being linked through the world market. Marx explained the ten-year periodicity of cycles endogenously, by reference to the replacement time of basic capital goods.

Within the GOLD STANDARD framework then in existence, Marx suggested that economic crises usually occurred after a correcting movement in the EXCHANGE RATE or once the import of precious metals again exceeded exports following a period of decline. A drain of gold overseas could be a sign of an approaching crash, but the crash would not usually occur until the drain had ceased. Marx believed that the size of the stock of precious metals in a country was determined by the country's role in the world market – a secular drain of metal being a symptom of a shift in the structure of international trade. The value of gold varied as the costs of production changed. Regarding monetary theory in general, Marx upheld the contra QUANTITY THEORY OF MONEY (QTM) – the view that the causal relationship ran from prices to the money supply and not vice-versa.

In relation to the international division of labour (see DIVISION OF LABOUR, INTERNATIONAL), Marx supported FREE TRADE against protectionism, but only because he believed it heightened class antagonisms on an international scale and assisted in dissolving national boundaries. Marx mocked the idea of a country's natural destiny in manufacturing and suggested that protection helped to encourage free trade, since once domestic production was established, dependence on the world market was henceforth assured. He argued that key branches of industry existed on the world market which dwarfed all others – cotton, for example – and this gave the countries that dominated the production of such goods decisive command in international trade. According to Marx, richer countries exploited poorer ones through the exchange of less labour time for more. The idea of the world market as the culmination of capitalism was strongly present in Marx's writings, as the final instalment of his 'Critique' was intended to demonstrate.

Another international tendency within capitalism identified by Marx was the growing concentration and centralization of capital, which occurred because there were victors and vanquished in the competitive process. Marx saw this as occurring together with the growth of the credit system, which was a mechanism for capital centralization. Later Marxists, such as RUDOLF HILFERDING and Lenin, saw this tendency as leading to a new phase of capitalism called MONOPOLY CAPITALISM. Marx predicted that the monopoly of capital would lead to the increasing immiseration of the working class, to growing social polarization and to the hindering of technological progress, these being the final fetters on economic development that would provoke revolution. In reality, the monopolistic and competitive tendencies of capitalism have co-existed throughout the twentieth century, producing a rising living standard for many workers, a growing middle class (at least in developed countries) and increasing technological progress.

Marx's work was characterized by sporadic flashes of insight into international economic development as a process, and by a recognition of the need to incorporate social relations into economic thinking. But it suffered from inconsistencies that grew from his inability to complete his research – partly due to adopting a method *a priori* – and from a reluctance to admit that his views had changed as his understanding deepened. Marx's status as a pioneer is assured, but perhaps more as a social theorist and historian than as an economist.

See also:

immiserising growth; Maoism; Marxian economics; Marxism Leninism

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VINCENT BARNETT

Marxian economics

'Marxian economics' refers to the economic theory formulated and developed by KARL MARX (1818–83). By extension, the term refers to all theoretical approaches that are predicated on Marx's economic concepts (Howard and King, 1989; 1992).

Marx developed his economic theory, under the rubric of 'A critique of political economy', mainly in the period 1857–67. It is a well-defined system, structured as a logical array of original concepts and analyses rooted in theories of value and SURPLUS VALUE. Marxian economics emerged from Marx's earlier historical-sociological analyses and is formulated with a new methodological approach.

Marx's mature economic writings consist of the following works: the *Manuscripts 1857–58*, (first published in 1939–41 as *Grundrisse: Foundations of the Critique of Political Economy*); *A Contribution to the Critique of Political Economy* (first published 1859); the *Manuscript 1861–63* (comprising nearly 2,500 printed pages), a part of which was first published during the period 1905–10 under the title *Theories of Surplus Value*; the *Manuscripts*

1863–7 (containing drafts of the three volumes of *Capital: A Critique of Political Economy*), and Volume 1 of *Capital* (first published in 1867). In the second (1872–3) edition of Volume 1 of *Capital* (Marx, 1990), Marx revised Part I of the book (entitled 'Commodities and money'). Volumes 2 and 3 of *Capital* (Marx, 1992; 1991) were edited and first published by Engels in 1885 and 1894 respectively.

Theoretical background: Marx's theory of history

The economic theory of Marx is firmly embedded in the theory of history that he formulated and developed jointly with Friedrich Engels in the mid-1840s. Starting from his *Theses on Feuerbach* (1845), Marx rejected the entire tradition of theoretical-philosophical humanism (the conception that the individual or human nature determines the form and evolutionary pattern of societies). He wrote:

Feuerbach resolves the religious essence into the human essence. But the human essence is no abstraction inherent in each single individual. In its reality it is the ensemble of the social relations.

(Marx, *Theses on Feuerbach*: 6th thesis)

On this basis, Marx formulated his concept of CLASS STRUGGLE as the motive force of social evolution: 'The history of all hitherto existing society is the history of class struggles' (Marx and Engels, 1985: 79).

Marx grasped the unity and coherence of SOCIETY in terms of social-class power. Power no longer constituted the 'right of the sovereign' or the 'power of the STATE' in relation to (equal and free) individuals, but a specific form of class domination of the ruling class over the dominated classes of society. Marx saw it as stabilized on the basis of dominant social structures and reproduced through class antagonisms.

In the framework of this analysis, Marx regarded the economy as the actual basis of the whole class society – with property relations *vis-à-vis* the means of production as the keystone of class identity. CAPITALISM is thus

conceived as a social regime characterized by the complete separation of the labourers from the means of production, which are monopolized by the ruling class of capitalists. The labourer becomes a proletarian without property, who must exchange labour power for a wage from the capitalist, whereby the capitalist becomes the owner of all value produced by the wage labourer: 'Capital [is] that kind of property which exploits wage labour, and which cannot increase except upon conditions of begetting a new supply of wage labour for fresh exploitation' (ibid.: 96–7). However, until 1857 Marx's analysis was derived from the Ricardian theory of value, as he had not yet developed a distinctive value theory.

Value, abstract labour and money

According to the main postulate of the Ricardian theory of value, COMMODITIES are exchanged with each other at relative quantities reflecting the relative quantities of labour necessary for their production. Consequently, the value of each commodity corresponds to the quantity of labour bestowed on its production (see LABOUR THEORY OF VALUE; RICARDO, DAVID).

Marx revolutionized the Ricardian theory of value in two ways: on the analytical level and on the methodological level.

On the analytical level, Marx conceived of value as a (historically) specific social relation: value is the identity that the products of labour acquire under capitalism, an identity which is realized on the market through their exchangeability with all other products of labour – that is, through their character as commodities carrying a specific money-price on the market.

Had we ... inquired under what circumstances all, or even the majority of products take the form of commodities, we should have found that this can only happen with production of a very specific kind, capitalist production.

(Marx, 1990 [1867]: 273)

Value is thus not a property which in all historical cases is infused into the products of

labour by the individual labourer. Furthermore, under capitalism, it is not only the products of labour that become commodities, but also the labour power of the working people who, in the course of history, have lost all property rights over the means of production and are obliged (by the threat of starvation) to sell their labour power to the capitalists (owners of the means of production) in order to be able to purchase the necessary means of subsistence.

Marx was now able to attack the question of commensurability (general exchangeability) of commodities. Where classical political economists believed that they had given an answer (qualitatively different objects – 'use values' – become commensurable – exchangeable – because they are all products of labour), Marx poses the question of why qualitatively different forms of labour are commensurable: 'What appears objectively as diversity of the use values, appears, when looked at dynamically, as diversities of the activities which produce those use values' (Marx, 1991 [1894]: 29). To answer the question, one must comprehend the social character of labour. The capitalist DIVISION OF LABOUR and the corresponding social organization of the production process is based on the direct (institutional) independence of each specific producer (capitalist) from all others (see SOCIAL ORGANIZATION OF PRODUCTION). However, all these individual production processes are indirectly correlated with each other through the market mechanism, as each one produces not for itself but for others – for the rest of society (the market). This induces the social (capitalistic) homogenization of all individual labour processes through generalized commodity exchange and competition between individual producers (capitalists). Marx expounds this process of social homogenization of the different labour and production processes by introducing the concept of abstract labour. Labour in capitalism is, on one hand, concrete labour (producing a concrete use-value) and, on the other, abstract labour – labour of equal social quality that enables the general commensurability and exchange of commodities: 'The labour expressed in

exchange value is abstract universal social labour, which is brought about by the universal alienation of individual labour' (ibid.: 56–7).

On the methodological level, Marx introduced a theory of the forms of appearance of economic and social relations, as distinct from the internal, hidden, causal regularities (or laws) governing these relations which are not detectable on the level of observable phenomena. As he had already explained in his first text of the period (the 'Introduction to the *Grundrisse*'), the purpose of economic science is to start from these concrete forms of appearance, only to abstract from them and thereafter return to them by a new, theoretical path which would allow for the formation of the theoretical concepts of the phenomena – concepts that would reveal the internal causalities regulating the observable phenomena. Marx's methodology thus constitutes a rupture with all forms of empiricism, since it bases itself on the thesis that empirical observation does not suffice for the comprehension of causality in economic processes. As he puts it:

the form of appearance ... makes the actual relation invisible, and indeed presents to the eye the precise opposite of that relation ... just as the apparent motions of the heavenly bodies are intelligible only to someone who is acquainted with their real motions, which are not perceptible to the senses.

(Marx, 1990 [1867]: 680, 433)

The implication of the above theses is that value never expresses itself as such (is therefore never directly empirically conceivable or measurable), but only through its forms of appearance (the price of commodities). These forms of appearance refer not to the level of each individual commodity, but to the level of the market: they express each commodity's exchange relation with all other commodities – they materialize the social homogenization of labour (as denoted by the notion of abstract labour).

The form of value (that is, the directly observable quantity which expresses (executes) the general exchangeability of commodities) is MONEY: it is the general equivalent of the exchange process, as all commodities express in

it their exchange value. Having acquired the sole function of expressing and measuring value, money (even if it is a special commodity: gold) does not possess value itself, since if the opposite were true 'it would have to be brought into relation with itself as its own equivalent' (ibid.: 189), which is obviously meaningless. As the general form of appearance of value, money is conceived by Marx as the 'material embodiment of abstract and therefore equal human labour' (ibid.: 184).

Unlike its Ricardian predecessor, the Marxian theory of value is a monetary theory. The value of a commodity cannot be determined as such, but only through its form of appearance – it cannot be determined in isolation, but only in relation with all other commodities in the exchange process. This exchange–value relation is materialized by money. In the Marxian system, no other 'material embodiment' of (abstract) labour and no other quantitatively defined form of appearance (or measure) of value can exist. Money functions as a measure of value, as the means of circulation (a special case of which is international money), as a means of hoarding and as money CAPITAL – which is its most significant economic function in capitalism. Marx introduces his analysis of money as capital, under the subtitle 'Means of payment', in the third section of Chapter 3 of Volume I of *Capital* (that is, before defining the notion of capital or interest), only to continue it in Part II of Volume I and in Part V of Volume 3.

When analysing the function of money as a means of circulation, Marx underlines the fact that exchange of commodities is a dual process of sale and subsequent purchase, in accordance with the formula $C-M-C$ (where C stands for commodity and M for money). This split of exchange into two subprocesses constitutes a general possibility of economic crises, which classical economists (following SAY'S LAW) failed to comprehend because they eliminated money and approached exchange as if it were an act of barter.

The Marxian theory of value refers simultaneously to the notion of abstract social labour (as the causal determinant or the 'essence' of value) and to money (as its necessary form of

appearance). Value is thus a social relation accruing from the social homogenization of labour under capitalism and manifesting itself in the general exchangeability of commodities on the market. From a quantitative point of view, the value of a commodity *would be* the quantity of *socially necessary labour* (that is, labour possessing the socially average characteristics of production technique, skill, intensity and so on) expended on its production. However, the necessarily distorted form of appearance of all causal determinations results in relative prices of commodities that, in the general case, differ from what their relative values would be. Marx, after making clear that 'the possibility of a quantitative incongruity between price and magnitude of value ... is inherent in the price form itself' (ibid.: 196), nevertheless assumed in Volumes 1 and 2 of *Capital* that commodities exchange at their values – as in those texts he was mainly concerned with the study of the causal determinations (the 'essence') of the capitalist economy. In Volume 3, however, Marx abandoned this assumption as he began to concentrate on the forms of appearance of the capitalist relations of production. There he introduced the concept of production prices as the transformed forms of value ensuring the equalization of the profit-rate of all individual capitals, which are bound together in the framework of a capitalist economy through competition (see below).

Capital, surplus value, accumulation

Marx's capital theory is based on his concept of value. Capital is value which, although created by the labouring class, has been appropriated by the capitalists. Being value, capital appears as money and commodities. It is, however, specific commodities that function as capital: means of production (constant capital) on one hand and labour power (variable capital) on the other.

For labour power to be a commodity, a long historical process of social change and revolution must have taken place, from which there emerges the free labourer:

free in the double senses that as a free man he can dispose of his labour-power as his own commodity and that on the other hand he has no other commodity for sale, i.e. he is rid of them.

(Marx. 1990 [1867]: 272)

The formation of the capital–wage–labour relation is thus a historically specific form of class power which is inseparable from the institutional, legal and ideological edifice of the 'free person' and equality. Marx describes this historically specific social order as the 'capitalist MODE OF PRODUCTION'.

Sale and purchase of labour power does not contravene the exchange of equivalents, on which every market is based: On the labour market, the capitalist and the labourer meet each other 'on a footing of equality as owners of commodities' (ibid.: 271). The labourer gets from the capitalist a *real wage* – that is, an ensemble of commodities that is necessary for the maintenance and reproduction of his labour power. For Marx, the magnitude of the real wage is determined historically. However, it cannot be reduced below the physically necessary means of subsistence, nor can it be raised to a level allowing the worker to change his social position (to purchase means of production). The decay of the labouring ability of the workers determines the lower limit; overpopulation of labourers (the 'reserve army of labour', as Marx named it) and periodically increasing unemployment, due to economic fluctuations and crises (see below) safeguard the upper limit. The *nominal wage* is the value of (all commodities comprising) the real wage.

The use-value for the capitalist of the labour power purchased is that it produces (as it is consumed productively in the labour process) commodities containing more value than its own. If v is the value of one unit of labour power (the variable capital advanced by the capitalist), then the new (net) value produced by it would be $v + s$, where s is the **SURPLUS VALUE** – the portion of the produced value that the capitalist acquires. The labour process is thus simultaneously a process of valorization and of surplus-value production. The working

day is divided into the *necessary labour time* (during which each labourer produces a value equal to that of their labour power) and the *surplus labour time* (in which surplus value is produced). If c is the (pre-existing) value of the means of production that are worn out in the production process (or the amortization), then the (gross) value of the produced output will be $c + v + s$.

Surplus-value production is a process of EXPLOITATION of the labourers by the capitalist. Marx defines as 'exploitation rate' (or surplus-value rate) the quotient s/v . The aim of capitalist production is to increase surplus value and the rate of exploitation. This is a moment inherent in the capital relation, which shapes the will of its 'bearer' (the individual capitalist), who functions 'as capital personified and endowed with consciousness and a will' (ibid.: 254). Surplus-value increases accruing from a prolongation of the working day or from the intensification of labour are regarded by Marx as production of *absolute surplus labour*. However, increases in s/v also result from increases in productivity of labour, which suppress the value of unit commodities and consequently reduce nominal wages if real wages remain unchanged (or even increase at rates lower than the increased rates in labour productivity). This process is defined as production of *relative surplus labour*.

Money acting as capital unifies the capitalist production and circulation process, in accordance with the following scheme:

$$M \rightarrow C (= M_p + L_p) \rightarrow P \rightarrow C' \rightarrow M'$$

The capitalist appears on the market as the owner of money (M) purchasing commodities (C), these being means of production (M_p) and labour power (L_p). In the production process (P), he productively consumes C , to create an output of commodities (C'), whose value exceeds that of C . He finally sells this output to gain an amount of money (M') higher than M . So the 'circulation of money leads to capital' (Marx, 1993 [1857–8]: 776). Money appears to possess 'the occult ability to add value to itself' (Marx, 1990 [1867]: 225). This is

most clearly the case for loan (or interest-bearing) capital, which the banker or money-capitalist lends to the industrialist. The surplus value created in the production process is then divided into industrial profit and interest, the latter apparently accruing automatically from loan-money itself.

The surplus value ($s = M' - M$) acquired by the capitalist is transformed partly into the capitalist's own means of private consumption and partly into additional constant and variable capital (that is, additional means of production and labour power) for the expansion of production. This last process (that is, the transformation of surplus value into capital) is defined as accumulation. Through accumulation, the capitalist economy is reproduced on an expanded scale. (In the special case of no accumulation – namely, when all surplus value goes to the capitalist's private consumption – we have simple reproduction.) In Volume 2 of *Capital*, Marx formulates the conditions of uninterrupted reproduction of a pure capitalist economy as comprising two sectors: one produces means of production for the whole economy and the other produces means of consumption for all labourers and capitalists.

Let $c_I + v_I + s_I$ be the output of Sector 1, producing means of production. In the case of uninterrupted expanded reproduction, this output must be equal to the demand of both sectors for means of production (for amortization and accumulation) – that is, $c_I + v_I + s_I = c_I + \Delta c_I + c_2 + \Delta c_2$. Considering that $s_I = \Delta c_I + \Delta v_I + pc$ (where $\Delta c_I + \Delta v_I$ refers to the accumulation of constant and variable capital and pc to the personal consumption of the capitalists of Sector 1), we finally conclude that the consumption expenditure in Sector 1 must be of equal value to production expenditure in Sector 2:

$$v_I + \Delta v_I + pc = c_2 + \Delta c_2 \quad (\text{Relation 1})$$

Prices of production

The distorted forms of appearance of economic relations do not designate a false impression in

consciousness, but a reality which is the outcome of class power and precludes the apprehension of causalities behind it. In this context, labour power appears to be incorporated in capital as variable capital. The products of labour thus appear to be products of capital. The result is the formation of commodity prices such that the profit accrued on all individual capitals tends toward the average profit – that is, a profit corresponding to the average profit rate of the economy (see Relation 4, below). Since different individual capitals generally have different relative portions of constant (c) and variable (v) capital, the relative prices of the commodities they produce are different from what their relative values would be. On the basis of this approach, Marx solves a problem that tormented Ricardo and his school.

For each individual capital, the cost price in value terms (k) is defined as the expense in constant (c) and variable (v) capital, that is the sum $k = c + v$. Assuming a constant rate of exploitation s/v , the value of a commodity would be:

$$W = c + v(1 + s/v) \quad (\text{Relation 2})$$

And for a given cost price ($c + v$ is constant) it would increase with v (with decreasing c/v).

Conversely, for a given profit rate (r) and assuming, for mathematical simplicity, that all constant capital wears out in each production process (that is, $C = c$), the production price of the commodity would be:

$$P = (c' + v')(1 + r) = k'(1 + r) \quad (\text{Relation 3})$$

Where $c' + v'$ is the cost price (k') in price terms. It is clear that P remains unchanged for a given cost price ($c' + v'$ is constant), irrespective of changes in the ratio c'/v' .

Marx calculated production prices starting from values and erroneously used the cost price in value terms (k instead of k') to calculate production prices (P). Ladislav von Bortkiewicz (1907) first 'corrected' Marx's mathematical errors (see Bortkiewicz, 1949).

'Fetishism'

Prices of production disguise exploitation relations since 'surplus-value appears as having arisen from the total capital' (Marx, 1991 [1894]: 267) and not from labour. The wage then appears as the 'price of labour' (Marx, 1990 [1867]: 680) and not of labour power; capital appears to be a self-valorizing medium.

Marx denotes as 'fetishism' the disguising effects that are inherent in the forms of appearance of 'capitalist relations', which make the latter manifest themselves *as relations between things*. Through fetishism, social relations (capital, value) appear as material objects (means of production, gold). Marx especially emphasizes the fetishist character of revenue forms (rent apparently accruing from 'land', profit from the 'means of production') and of interest-bearing capital, which 'displays the conception of the capital fetish in its consummate form' (Marx, 1991 [1894]: 523) as money appears to create money. However, the introduction of the notion of 'COMMODITY FETISHISM' before that of capital, in Volume I of *Capital*, gave rise to disputes over the philosophical significance of fetishism in Marxian theory.

Technological innovation and the tendential fall in the profit rate

The tendency of the profit rate to fall has been part of the economist's credo since the classical era. Ricardo tried to present it as a result of increasing rent payments by farmers to landlords, triggering an upward surge in wages and a corresponding fall in profits due to price increases in wage-commodities.

Marx, with his law of the *tendential fall* in the rate of profit, shows that technological innovation aimed at increasing labour productivity and induced through competition could be the cause of such a phenomenon. He bases his analysis on the notions 'technical composition of capital' (designating the number of means of production per labour unit in material terms) and 'value (or organic) composition of capital' (the ratio of constant to

variable capital, in value terms). The technical composition of capital increases with accumulation and technical innovation. Marx argues that, all other factors remaining unchanged, a fall in the rate of profit may occur when the technical composition of capital increases faster than the productivity of labour induced by it.

Considering the rate of profit to be the dependent variable (R), one may write:

$$R = \frac{s}{C+v} = \frac{s/v}{(C/v)+1} \quad (\text{Relation 4})$$

Where C stands for constant capital, s/v for the exploitation rate (surplus-value rate) and C/v for the value (organic) composition of capital.

It can be shown that C/v is a positive function of T/p , where T is the technical composition of capital and p the productivity of labour (or the inverse of the value of one unit of product). So, if T rises faster than p , the value composition of capital increases. In all cases where this increase is faster than the increase in the exploitation rate (s/v), the tendential fall in the profit rate prevails over the counteracting tendencies.

Following the logic of Marx's analysis, one may say that in all cases where technical innovation does not cause higher increases in the technical composition of capital than in labour productivity, an upswing in the profit rate takes place. The upward trend in the profit rate prevails also when the exploitation rate increases faster than the organic composition, or where the organic composition decreases faster than the rate of exploitation. Marx himself writes:

The rate of profit could even rise, if a rise in the rate of surplus-value was coupled with a significant reduction in the value of the elements of constant capital, and fixed capital in particular.

(Marx, 1991 [1894]: 336–7)

It was Engels who added to this text the following phrase, which is not to be found in Marx's original manuscript: 'In practice, how-

ever, the rate of profit will fall in the long run, as we have already seen'.

Economic crises

Having rejected Say's Law in the light of his own monetary theory of value, Marx regarded economic crisis as a conjunctural OVERPRODUCTION of commodities, having as its corollary the retardation of the able-to-pay demand (UNDERCONSUMPTION). There has been a lot of dispute among Marxists and non-Marxists as to which of these two simultaneously appearing elements constitutes the decisive structural relation of economic crises in capitalism. Whatever the truth of the matter, Marx considered crises not simply as a reflection of lack of equilibrium between supply and demand, but as an imbalance affecting all aspects of capitalist expanded reproduction. A crisis results in a fall in the profit rate and indicates a reduced ability of the capitalist class effectively to exploit labour.

Periodically, too much is produced in the way of means of labour and means of subsistence, too much to function as means for exploiting the workers at a given rate of profit.

(ibid.: 367)

However, crises are merely temporary destabilizations of the capitalist process of expanding reproduction. Moreover, they simultaneously function as mechanisms 'that re-establish the disturbed balance for the time being' (ibid.: 357).

As regards the fall in the profit rate, Marx did not reduce crises to the law of the tendential fall, since he incorporated in his analysis *all* factors that increase the organic composition (or reduce the exploitation rate), not just increases in the technical composition of capital due to technical change. One example might be an abrupt increase in prices of raw materials: 'Violent fluctuations in price thus lead to interruptions, major upsets and even catastrophes in the reproduction process' (ibid.: 213).

The most important of such factors is the increase in the value of constant capital that is necessary for the production of one product unit. Let the quantitative expression of this

factor be C/Y , where C is the constant capital and Y the net product (the sum $s + v$ of surplus value and value of the labour power). The organic composition of capital (C/v) depends on s/v on one hand and on C/Y on the other:

$$\frac{C}{v} = \frac{C}{Y} \cdot \frac{Y}{v} = \frac{C}{Y} \cdot \frac{(s+v)}{v} = \frac{C}{Y} \left(\frac{s}{v} + 1 \right)$$

(Relation 5)

Marx studied the variety of factors determining C/Y (such as the length of the working day, the skill and education of workers, the concentration of production, technological aspects and so on) in Part I of Volume 3 of *Capital*, under the rubric 'Economy in the use of constant capital'.

Ground rent

According to Marx, there exist different forms of ground rent, resulting from the concrete social relations that prevail in agriculture. Under the domination of the capitalist mode of production, ground rent is paid by capital advanced in agriculture (that is, by farmers) to the owners of the land, as a result of the ownership-monopoly on the ground held by the latter. Rent is an extra profit created by labour over the average profit of capital. Marx then distinguishes two forms of ground rent: 'differential rent' and 'absolute rent'.

Private property on the land does not create but merely displaces differential rent from the farmer to the landowner. Differential rent springs from higher labour productivity (which creates extra profits) either in the more fertile or better situated lands (Differential Rent 1) or in lands with higher capital investments (Differential Rent 2). It is, therefore, the conversion of an extra profit into rent: this extra profit results from the difference between the (higher) market price (which is determined by the price of production of capital advanced in the marginal land – that is, the land that does not give differential rent) and the (lower) 'individual price of production' of each other capital that is advanced in better lands. Unlike MALTHUS or Ricardo, Marx disconnected

differential rent from the so-called 'law of diminishing returns of the soil': 'Differential rent can arise with a progression to ever better soil ... Its only precondition is the inequality of types of soil' (Marx, 1991 [1894]: 798).

Absolute rent is created exclusively by the monopoly of private property on every land. It springs from an excess of value of agricultural products over their production price. Even in the marginal land, 'landed property has created this rent itself' (ibid.: 889): however, this is a possibility depending on 'the general state of the market' (ibid.: 898) and the conjuncture of class struggle. The precondition for value produced by an individual capital to be higher than the production price is that capital's lower organic composition, as compared with that of the average social capital. Consequently, the lower organic composition of capital advanced in agriculture (which Ricardo refused, neglecting thus the absolute rent) results in the production of a higher surplus value in agriculture, as compared with any other sphere of production. The ownership-monopoly on the land, functioning as a barrier, blocks this extra surplus value from entering the process of general equalization of the profit rate: it is cashed by the landowner as absolute rent (ibid.: chap. 44).

Marx analysed also the pre-capitalist forms of ground rent, which appear as 'labour rent', 'rent in kind' or 'money rent'. In the feudal mode of production, 'labour rent' and 'rent in kind' consisted in the 'dominant and normal forms ... of surplus labour and surplus product' (ibid.: 930). The form of labour rent absorbed the total of surplus labour, whereas rent in kind might not necessarily absorb the total surplus product. Money rent is, in most cases, 'a formal transformation of the rent in kind' (op. cit.), designating, though, the dissolution of pre-capitalist and the emergence of the capitalist forms of rent.

Non-capitalist modes of production and capitalist development

Marx's conception of the capital relation as the decisive characteristic of a historically specific form of economy and society was synonymous

with his effort to grasp 'the specific characteristics which distinguish capital from all other forms of wealth – or modes in which (social) production develops' (Marx, 1993 [1857 8]: 449). This effort led him to think about the 'forms, which precede capitalist production'. Consequently, his concept of the capitalist mode of production as the causal nucleus of capitalist social relations presupposed the notions of non-capitalist modes of production (for example, feudal, slave-owning and so on).

In the specific form of exploitation (surplus form and its mode of appropriation and distribution) arising from the ownership relations corresponding to the means of production, Marx saw 'the hidden basis of the entire social edifice, and hence also the political form of the relationship of SOVEREIGNTY and dependence' (Marx, 1991 [1894]: 927).

The following question now arises: Under what conditions are pre-capitalist social structures replaced by the capitalist mode of production and to what extent may they constitute an impediment to capitalist DEVELOPMENT? Many authors have portrayed Marx as an advocate of a 'progressivist prognosis', according to which all countries will inevitably go through the same stages of economic and social evolution, from pre-capitalist forms to developed capitalism, culminating in SOCIALISM. Although such formulations can be found in the work of Marx and Engels (the introduction to *A Contribution to the Critique of Political Economy* is an example), the 'progressivist prognosis' does not prevail in the economic writings of Marx's maturity. Marx recognizes mainly the *possibility* of capitalism emerging as a *consequence of class struggle* and he outlines the prerequisites for such a historical development.

In an 1881 letter to the Russian socialist Vera Zasulich, Marx wrote:

I have shown in *Capital* that the transformation of feudal production into capitalist production has as its starting point the expropriation of producers, which mainly means that the expropriation of the peasants is the basis of this whole process ... Surely,

if capitalist production is to establish its domination in Russia, then the great majority of the peasants must be transformed into wage-earners. But the precedent of the West will prove here absolutely nothing.

(Marx and Engels, 1969–77: vol. 19, pp. 396–400).

Only in the event of the capitalist mode of production becoming, through class struggle, fully dominant in a social formation is capitalist development established as an inherent tendency of social evolution:

But this inherent tendency to capitalist production does not become adequately realised – it does not become indispensable, and that also means technologically indispensable – until the specific mode of capitalist production and hence the real subsumption of labour under capital has become a reality.

(Marx, 1990 [1867]: 1,037)

Discontinuities and contradictions in Marx's writings

In the course of his writing, Marx changed the plan of his work: while in 1857–9 he planned to write a six-part 'critique of political economy' (dealing with capital, landed property, wage labour, the state, external trade, and the world market and crises), later on he worked out the plan of the three books of *Capital*, in which capital, wage labour and rent are dealt with simultaneously in the analysis of the production and circulation process of capital. This change of plan is due mainly to a modification in concepts. Initially, Marx thought of the distinction between causal determinations and forms of appearance in terms of 'capital in general' and the 'competition of many capitals' (the latter being conceived as the form of appearance of the former). However, his analysis of the formation of a general profit rate led him to comprehend competition also as an internal determinant of the capital relation. So in *Capital* he abandoned the notion 'capital in general' and formulated the concepts of 'social capital' (involving all

causalities of the capital relation on the level of the whole economy) and 'individual capital'.

Apart from this modification of ideas, which constitutes a theoretical discontinuity in Marx's work, there are discussions among Marxists as to whether some of Marx's elaborations are consistent with his own system, or whether they incorporate theses of classical political economy – reflecting the contradictions of Marx's departure from Ricardian theory. Some of his theses on crises, absolute ground rent and the transformation of values into production prices raise such questions.

Finally, mutually contradictory theses sometimes appear in Marx's writings. The most characteristic example has to do with whether capital in the circulation process should be regarded as productive or unproductive. In the *Grundrisse* (as well as in Volume 1 of *Capital*), Marx considers all capital forms equally productive (that is, producing surplus value):

Insofar as circulation itself creates costs, itself requires surplus labour, it appears as itself included within the production process ... Circulation can create value insofar as it requires fresh employment ... in addition to that directly consumed in the production process.

(Marx, 1993 [1857–8]: 524, 547)

However, in Volume 3 of *Capital*, Marx defined circulation capital as unproductive: 'Commercial capital ... creates neither value nor surplus-value' (Marx, 1991 [1894]: 395).

These discontinuities or contradictions in the work of Karl Marx have only a minor effect on his theory, as they remain marginal and do not overshadow the consistency of the major notions and analyses on which his theory is built.

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JOHN MILIOS
GEORGE E. ECONOMAKIS

Marxism–Leninism

Marxism–Leninism is the core upon which structural theories of the international political economy are based. It relies on the notion that both domestic and international politics are fundamentally concerned with the struggle for wealth among economic classes.

The theory began with the writings of KARL MARX who, through his time spent in England observing the impact of the INDUSTRIAL REVOLUTION during the nineteenth century, discovered that there was an ever-increasing gap between rich and poor. Expanding on the earlier insights of Jean-Jacques Rousseau, Marx argued that social inequality and human ALIENATION are the outcomes of a social DIVISION OF LABOUR. Indeed, central to Marxism is the claim that the MODE OF PRODUCTION determines the nature of social and political relations within political entities and among them. Thus Marx (along with his co-author Friedrich Engels), in an examination of history and nineteenth-century Britain, developed a philosophy founded on ‘dialectical materialism’, in which the way that economic production was organized was decisive in the institutional and ideological arrangement of a given society. Thus those who control the economic system would control the political system too. Central to this vision was a particular idea of history and the notion that each period in history contained opposing forces (a ‘dialectic’) from which a new system would eventually emerge. For Marx, all history is the history of CLASS STRUGGLE between a ruling group (those who owned the capital in a society) against an opposing group (those who owned the labour in a society). From this struggle would emerge a new economic, political and social system. In more formal terms, Marx’s model of society and the way it undergoes change embodies a thesis (the ruling group) and an antithesis (an opposing group) that clash and thus bring about a synthesis (the new economic, political and social system).

Historically, a major dialectic was the struggle between FEUDALISM and the new

system brought about through the industrial revolution – a system in which a growing business class existed that derived its economic strength from trade and manufacturing. Thus, when a new mode of production develops, new classes arise and a new class becomes dominant. The result of the struggle between these two opposing forces was the new system of CAPITALISM, but Marx too saw it as containing the seeds of its own destruction. This destruction would result, Marx predicted, from the increasing poverty of the working class – the proletariat (see CLASS, WORKING) – in comparison to the increasing wealth accumulated by the ruling class that owned the CAPITAL. Such inequality would result in the overthrow of the ruling classes by the proletariat, whose numbers were increasingly swelled by the lower middle class in society as a result of them not having the capital to compete with the ruling classes.

One significant factor in Marx’s analysis was the doctrine of SURPLUS VALUE, which explained the way in which profit was accumulated by the capitalist ruling class. The reason for such accumulation lay in the relationship between a worker – the member of the proletariat – and his employer – the owner of the capital. Marx argued that a worker sells their labour power, or ability to work, rather than their labour. This differentiation between labour and labour power is important and defines the so-called LABOUR THEORY OF VALUE, as well as asserting a crucial characteristic of capitalism – that the actual process of work is carried out under the control of the new owner of the labour power: that is, the capitalist. The latter also controls the means of production.

Thus the value created by labour corresponds to the number of hours worked by the owner of that labour. However, the wage paid to the owner of that labour corresponds to the actual value of labour power. If the latter is greater than the value of the wages paid to the worker, there exists a surplus value that the capitalist can retain when the product is sold. In this way, according to Marx, the vast majority of the population in a capitalist

society is reduced to wage slavery. The level of surplus value increases as the owners of capital increasingly exploit workers. For Marx, the eventual clash between the capitalist class and the worker class will lead to a socialist order (see SOCIALISM). In this there will be a prolonged period of government control over the means of production and distribution and, as capitalism is removed, the state withers away to be replaced by a communist economic, political and socialist order (see COMMUNISM). For Marxism, then, the final end-state that will emerge will be the progress of industrial modernization to the eventual advent of communism. For the theorist of international political economy (IPE), one interesting point to note here is that all political interactions, including WAR, are manifestations of the prevailing economic system. Marx, however, although he realized that capitalism was international in nature (in that the owners of capital had control over an international supply of labour and raw materials), did not develop a theory of IMPERIALISM. This was left to LENIN who, building on the work of J.A. HOBSON and RUDOLF HILFERDING, described a theory of the international system that focused on the existing structures of dominance and dependence.

Lenin's central focus was on the role of MONOPOLY CAPITALISM in the international system which, for Lenin, corresponded to the notion of imperialism. Such monopoly capitalism had evolved from four factors in particular. The first was the concentration of production in combines, CARTELS, syndicates and TRUSTS. The second was the competitive search undertaken for sources of raw materials. The third was the development of banking oligarchies, while the final factor was the change that had occurred from 'old' colonial policies into a constant contest for spheres of economic interest in which the richer and more powerful nations exploit the weaker ones. In this theory of international interaction, Lenin provided a theory of imperialism that can be noted as the major communist theory of international relations (IR) in an international

system made up of capitalist states. In this, Lenin's views on imperialism were central.

Lenin perceived imperialism as the monopoly stage of capitalism. Capitalist states needed to export capital because the opportunities for investment in capitalist countries themselves diminished as time went on. In turn, by exporting capital in order to bolster investment opportunities, capitalist states would promote the spread of capitalism to other areas of the world. Moreover, the greater the development of capitalism, the greater the need for raw materials to produce goods and new markets to sell them in and, in turn, the more pressing the search for yet further investment opportunities in previously under-utilized markets. By having a level of political control over their foreign colonies, a capitalist state would ensure access to a reliable source of raw materials and cheap labour, as well as guaranteeing markets for the advanced capitalist states.

Lenin, writing in *Imperialism: The Highest Stage of Capitalism* (1939 [1916]), perceived the history of the previous generation as being characterized by the struggle between the advanced capitalist states for the control of these resources and markets. Indeed, capitalist countries (Lenin argued) had even at times formed alliances for the exploitation of these underdeveloped areas. Such alliances were, however, short-lived, soon being overtaken by the need for control over limited overseas markets and raw materials. Hence, as a result of the ultimate dependence of capitalist economic systems on such markets and natural resources, Lenin viewed international conflict as endemic in a world of capitalist states. The only way for such conflict to be abolished was to get rid of the system of capitalist states. In this way, Lenin's theory basically outlines a relationship between the structure of a state's domestic political and economic system and its foreign policy. By pursuing the policies that they did, capitalist states were seen by Lenin to increase the likelihood of international conflict. Thus the only way to rid the international system of such conflict was to rid the international system of capitalist states.

Like the rest of the major theories upon

which the contemporary understanding of IPE is based, Marxism–Leninism has been the subject of criticism. For Marxism–Leninism this has been more particularly the case given the collapse of many Marxist regimes in the late 1980s and early 1990s. Given that the international political economy is dominated by capitalist states, there is doubt cast on the ability of any Marxist regime to survive in an interdependent world that is dominated by capitalist states. Nevertheless, the dilemmas that continue to face capitalist states and the continuing debate over the role of poor states in the international system mean that there will continue to be a place for theoretical approaches based on Marxism–Leninism in the attempt to understand the contemporary international political economy.

See also:

Bolshevik; multinational corporations (MNCs); structuralism; world-systems theory

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ALISON M.S. WATSON

mature economy

With the admission of transformation countries of eastern Central Europe to the ORGA-

NIISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), the notion of economic maturity has gained international relevance again. The Knight Ridder *Social Science Citation Index* listed, by 15 April 1997, fifty-three very diverse entries from 1 January 1995 onwards that made explicit use of the term. During the optimistic 1950s and 1960s, economic maturity tended to be regarded by conventional DEVELOPMENT theory as the end-product of the development process, while more recent literature connects the term with the threat of stagnation and DEINDUSTRIALIZATION. Although often deployed, the concept evades exact definitions, and normative and empirical vagueness abounds. However, comparative empirical development research is able to shed some light on the subject.

The more pessimistic notion of 'maturity and stagnation' was first introduced by the Austrian Joseph Steindl (1952) as a counterposition to the then fashionable theories of modernization (see MODERNIZATION THEORY) and STAGES OF GROWTH. Empirically, there is a very clear curvilinear trade-off between development level and development performance, particularly growth, in the shape of an inverted 'U'. That is to say that economic growth levels off once a stage of maturity has been reached. More recent empirical research has developed these issues, with dependency and state-sector variables figuring high on the agenda of supposed development blocks in cross-national development research.

In a very tentative way, then, it can be said that 'economic maturity' will mean a tendency towards stagnation for the new Eastern European member-states of the OECD and the EUROPEAN UNION (EU) after 2004, following the end of the transformation and catching-up boom of the late 1990s and early 2000s that succeeded the transformation depression of the early 1990s. Strategies against relative decline are now much debated. However, there are few doubts about the value of education and human capital formation. Sometimes, in economics, it is easier to grow than to become mature.

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ARNO TAUSCH

Menshevik

The 'Mensheviks' were the minority political current of the Russian Social Democratic and Labour Party (RSDLP) originating (in opposition to the BOLSHEVIKS) in the split over party organization in the 1903 conference. Led by Martov, the Mensheviks rejected the call by LENIN for a tight-knit organization, preferring a looser party modelled on the mass social democratic parties of Western Europe, requiring less agreement or activity from its members.

Bolshevik criticisms of the Mensheviks anticipated those they levelled (after 1914) at European social democracy more generally: a fatalistic attitude to the revolutionary process leading to passivity with regard to direct struggle, a craven attitude towards bourgeois legality and parliamentarism, and a tendency to compulsive 'opportunistic' compromising with the bourgeoisie.

Mensheviks accused Bolsheviks of obsessive centralism and authoritarianism. Russia was ripe not for socialism but only for a bourgeois democratic revolt against Tsarist autocracy. The working class could not lead a social reconstruction and should not politically lead the revolution (see CLASS, WORKING). Socialists must cooperate with bourgeois liberals to create a democracy, not workers' power.

In the revolution of 1905, Mensheviks took an active part – leading to temporary rapprochement with the Bolsheviks. But afterwards, many Mensheviks rejected attempts to main-

tain a (then illegal) party organization, in favour of involvement in legal 'front organizations' (though Martov and Left Mensheviks sought to sustain illegal groups). Accusing the Mensheviks of 'liquidationism', the Bolsheviks split and the factions formed independent parties in 1912. In 1914, Menshevism was again divided. The Right wing supported 'national defence' in the war, opposed by a majority internationalist current.

When the 1917 February Revolution established a provisional government, the Menshevik majority (opposed again by Martov and the Left) swung round to support the continuance of war. As the revolution radicalized, the divided Mensheviks lost their leading role in the soviets to the Bolsheviks, who (after April) raised the slogans of land reform and ending the war, and argued that the soviets should take power. When the Bolsheviks led an insurrection in support of these demands in October 1917, the Mensheviks united in condemning it.

In the ensuing invasions and civil war, the Menshevik majority gave the Bolshevik regime critical support, forming a legal opposition – a position attacked by their own Right wing, some of whom joined counter-revolutionary governments. The period of legal opposition was punctuated by periodic repression and ended with suppression when the Mensheviks backed the Kronstadt Revolt (1921) against the Bolshevik government.

Until the 1960s émigré Mensheviks published a journal in the West, but the real legacy is more diffuse, living on in the analyses of the revolution's many critics. With the rise and collapse of Stalinism, many consider Menshevism to have been vindicated, arguing that the October Revolution was premature, since social conditions in Russia were not ripe for socialism, and Leninist politics caused Stalin's dictatorship.

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ANDREW WRIGHT

mercantilism

'Mercantilism' is a philosophy of political economy that emphasizes the centrality of the STATE. This refers not simply to a state-centric view of the international system, but also to the primacy of the state over other domestic actors and interest groups. This is distinct from LIBERALISM, for example, which exalts the individual.

In the seventeenth and eighteenth centuries, classical mercantilism was a collection of heterogenous theories that spoke to most questions of political economy and, in fact, shared many characteristics with liberalism. Eli Heckscher, in his classic study *Mercantilism* (1935), saw a fundamental continuity between mercantilism and liberalism as reactions against the political economy of medievalism. Both schools of thought also saw a long-run harmony between the goals of maximizing power and plenty. But classical mercantilism can be distinguished by its view of international trade as a ZERO-SUM GAME, by its emphasis on the importance of accumulating wealth and by its expectation that the national interest will often diverge from the sum of individual interests. Together these beliefs provided the theoretical justification for mercantilist policies, such as government intervention to regulate commerce in order to cultivate a trade surplus.

In 1776, classical mercantilist theory was eviscerated by ADAM SMITH in Book IV of *The Wealth of Nations*. Smith and his liberal followers argued convincingly that (1) wealth derived from productive capacity, not precious metals; (2) trade was positive-sum, not zero-sum, and (3) (following from the first two) the BALANCE OF TRADE and treasure was of sharply less consequence than previously believed. Each of these changes represented an

important departure from mercantilist thought.

In the late eighteenth and early nineteenth centuries, neo-mercantilists reconstituted mercantilism in the light of the liberal revolution, but they did so by incorporating, not rejecting, many liberal themes. Both ALEXANDER HAMILTON and FRIEDRICH LIST, two of the founding fathers of NEO-MERCANTILISM, accepted much of the teachings of Adam Smith. Hamilton placed his arguments in the context of 'exceptions' to liberalism and List was even more explicit about the extent to which his proposed interventionist measures must be regarded as exceptional. Trade was understood to be positive-sum and, as List wrote, '*The power of producing wealth is ... infinitely more important than wealth itself*' (List, 1885 [1841]: 133).

But the integration of liberal theory with statist assumptions (see STATISM) still yields distinctly mercantilist prescriptions. Concern for war was an important aspect of mercantilism, and the view that war was a salient feature of the international system (and was likely to remain so) is one element that was retained in the neo-mercantilist reconstitution. This is particularly clear in the writings of List, who emphasized the significance of assumptions regarding war in analyses of political economy. 'Adam Smith's Doctrine', List argued, 'presupposes the existence of a state of perpetual peace and of universal union.' Thus, while List recognized the benefits of free trade, he argued that the 'influence of war' required states to deviate from some of the policy prescriptions of liberalism (ibid.: 347, 316).

The threat of war also provided a philosophical foundation for statism, a fundamental tenet of both classical mercantilism and neo-mercantilism. State building – internal unification and external closure – was central to the mercantilist project. According to Heckscher, 'The state stood at the centre of mercantilist endeavours developed historically: the state was both the subject and the object of mercantilist economic policy.' In fact, more than half of Heckscher's massive study is devoted to the study of 'Mercantilism as a unifying system' in which, among other things,

'The aim was the superiority of the state over all other forces within a country' (Heckscher, 1935: vol. 1, p. 21).

The neo-mercantilist champion of statism and state-building is Gustav Schmoller, who asserted that mercantilism 'in its innermost kernel is nothing but state making', 'the creation of real *political* economies as unified organisms' (Schmoller, 1897: 50, 49). This distinction between the state and the sum of individual interests is yet another tradition which survived the transition from classical mercantilism to neo-mercantilism. The famed classical mercantilist Thomas Mun distinguished between the interests of the merchant and the state, noting (for example) that there will be patterns of trade by which 'the Commonwealth may be enriched ... when the merchant in his particular shall have no occasion to rejoyce'. Similarly, in other conditions the merchant may prosper, 'when nevertheless the Commonwealth shall decline and grow poor'. Other mercantilists held similar views on the potential incompatibility of public and private interests (Mun, 1949 [1664]: 25, 26).

List similarly asserted that 'the interest of individuals and the interest of the commerce of a whole nation are widely different things' (List, 1885 [1841]: 269). This type of argument was stressed as well by twentieth-century neo-mercantilists such as Stephen Krasner, who aimed to show that 'the state has purposes of its own' (Krasner, 1978: 330) in his carefully titled book, *Defending the National Interest*.

The disjuncture of the sum of individual interests from the national interest is particularly likely to occur when the state, due to its greater sensitivity to security concerns or its tendency to have a longer time-horizon than individuals, is more willing to accept short-term economic sacrifices in order to reap greater long-run rewards. At this intersection of time-horizons and security, neo-mercantilists develop policy prescriptions that diverge from the liberal model. Three crucial issues raised by neo-mercantilists relate to the *consequences* of specialization, the *composition* of trade and the *distribution* of the benefits from the gains from trade.

These concerns all flow from the neo-

mercantilist reformation, after the liberal revolution, of the mercantilist concern for interstate rivalry. Neo-mercantilists (such as Hamilton and List) did not deny the economic gains from trade, but questioned the consequences of specialization imposed by international market forces. Such specialization might offer optimal economic efficiency, but might also force a state to produce wool instead of steel, leaving such a state disadvantaged in a world characterized by conflict and the threat of war.

More subtly, the neo-mercantilists also raised the question of dynamic comparative advantage: whether specialization at a given moment would put a nation on a trajectory of relatively low growth. If, at such times, temporary protection or other measures would allow for specialization in more attractive products, then free trade would not be the optimal policy in the short run. The gains from trade are not denied – rather, this is a classic case of the state imposing short-term costs on society for greater benefits in the long run. Thus, the mercantilist concern for the balance of trade is rehabilitated with the neo-mercantilist concern for the *composition* of trade. (This also distinguishes neo-mercantilism from crude protectionism.)

Hamilton argued that 'the United States cannot exchange with Europe on equal terms'. Industry, left to itself, will not 'naturally find its way to the most useful and profitable employment', because of the 'difficulties incident' on initiating enterprise in the context of 'superiority antecedently enjoyed by nations'. Worse, other states may attempt to manipulate their commercial and domestic economic policies in order to shape the trajectory of comparative advantage. These 'bounties, premiums and aids' Hamilton declared to be the 'greatest obstacle of all' (Hamilton, 1971: 266, 268). State intervention to manipulate comparative advantage has been a perennial concern of neo-mercantilists, resurfacing 200 years later in the name of strategic trade and industrial policy (Tyson, 1992).

Even in the absence of concerns for dynamic comparative advantage, neo-mercantilists

would still see a need for state intervention in order to monitor the distribution of gains in a static setting. Individuals need be concerned only with their absolute gains in any transaction. But given the possibility of war, states must be concerned with the distribution of those gains, lest potential adversaries become strengthened. ROBERT GILPIN argues that 'the distinction between absolute and relative gains' is 'a fundamental difference in emphasis' between the liberal and neo-mercantilist perspectives (Gilpin, 1975: 33). While this issue was central to late twentieth-century debates (Grieco, 1988), it too can be traced to its classical origins. In 1684, P.W. von Hörnigk stated that the wealth and might of a nation depends 'principally on whether its neighbours possess more or less of it. For power and riches have become a *relative* matter'. A decade earlier, the English mercantilist Coke wrote 'if our treasure were more than our Neighbouring nations, I did not care whether we had one-fifth part of the treasure we now have' (Heckscher, 1935: vol. 2, p. 22). While neo-mercantilists have increased the sophistication of their analyses with the integration of liberal theories, the primacy of the state and heightened sensitivity to international conflict yield the remarkable endurance of mercantilist thought across time.

See also:

economic realism

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JONATHAN KIRSHNER

merchandise trade

'Merchandise trade' refers to importing and exporting physical goods, both manufactured goods and commodities. Internationally, merchandise trade continues to be more important than trade in services, but recently it has been easily overtaken by the value of overseas investment and capital flows.

JOHN WALSH

merchant banks

In the banking sector in the United Kingdom, it is possible to identify two broad groups of

merchant capitalism

institutions: those providing banking services for retail, usually referred to as retail banks, and those domestically owned banks which are not involved in retail activities. The latter group includes the so-called 'merchant banks', a closed club of City institutions (see LONDON, CITY OF) which once constituted the exclusive membership of the prestigious Accepting Houses Committee. The most famous among the UK merchant banks are Rothschild, Morgan Grenfell, Kleinwort, Waerburg and Lazard.

The banking business of the merchant banks in the United Kingdom is composed almost exclusively of wholesale activities – that is, dealing with other institutions in large sums of money. However, this group of banks is also very active in non-banking services. A very lucrative service strongly developed by the City's merchant banks is investment management, particularly fund management, which probably contributes nearer a half than a third of the banks' profits in aggregate. Another field merchant banks have made mostly their own is that known as 'corporate banking'. This involves a number of services to the corporate sector, including advising companies on 'merger and acquisition' (M&A) activity, handling share offers, and devising methods for restructuring or arranging UNDERWRITING facilities.

See also:

investment banks

L.S. TALANI

merchant capitalism

KARL MARX distinguished 'merchant capital' from 'industrial' and 'finance capital'. Merchant capital was important in the earliest phase of capitalist development, during which merchants made profits by using savings to trade in raw materials and the products of small-scale pre-capitalist manufacturing. As capitalism developed, merchant capital proved vulnerable to emerging industrial and finance

capital. To protect their investment in fixed assets, industrial capitalists tended to integrate vertically, assuring themselves of reliable supplies of raw materials and secure access to markets. In doing so, they bypassed and displaced independent merchants. At the same time, modern financial institutions – often developing out of merchant firms (which is why the British still call investment banks 'merchant banks') – took over the foreign exchange, credit and insurance functions of merchant capitalism. The historic importance of merchant capital for Marx lay in its two-fold function of creating concentrations of wealth which would later be available for industrial investment, while simultaneously hastening the commodification of production by providing wholesale outlets for standardized goods. Unlike industrial capital, merchant capital inclined to political conservatism in alliance with the landowning class to which it aspired. As early as the middle of the nineteenth century, Marx observed that merchant capital in the most developed areas had been 'demoted from its earlier separate existence [to act] simply as the agent of productive capital' (Marx, 1981 [1894]: 444). It survived longest in those areas that were slowest to develop fully fledged capitalism: purely trading cities within the capitalist world (Marx draws a disparaging comparison between conservative Liverpool and radical Manchester!) and pre-industrial countries.

The characteristic features of nineteenth-century British merchant firms with international interests fit well with the definition and chronology offered by Marx. Lightly staffed, working to a great extent on commission, avoiding investment in fixed assets and highly mobile, these firms typically carried out a wide range of functions for a generation or more, before their extensive market knowledge and networks led them into the temptation of some line of business that offered extraordinary profits in exchange for the bondage of fixed assets. Classic examples of the transformation from merchant to industrial capital include the evolution of Shell from a merchant firm dealing in a miscellany of Oriental goods

(including decorative oriental shells) into a major oil producer. Provision of bulk storage facilities in Asiatic ports, designed to secure competitive advantage in the wholesale supply of kerosene, was rapidly followed by investment in oil tankers. To keep these fixed assets fully employed, the company needed secure supplies of crude, and this led it into exploration and the purely industrial process of refining.

Merchant capital survived longest in something like its nineteenth-century role, as predicted by Marx, in sparsely populated and less-developed areas and in the handling of raw materials. Even in these sectors, the development of more capital-intensive forms of storage eventually pinned down the light-footed merchants as, to take just two examples, the Hudson's Bay Company transformed itself into a chain of department stores and Cargill developed into the world's largest grain trader, as much through innovative design and massive investment in elevators and grain barges, as through keen trading.

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CHARLES JONES

Mercosur

The Southern Cone Common Market, widely known as 'Mercosur', was created in March 1991 by Argentina, Brazil, Paraguay and Uruguay. The agreement calls for a gradual elimination of all tariffs on goods traded among member-states and formation of a common external tariff (CET). About 80 per cent of all trade in the region has been traded duty-

free since January 1995. All products will be subject to free trade by 2000. The agreement requires members to harmonize macro-economic policies by 2006 (see **MACRO-ECONOMIC POLICY**), thus forming a full **COMMON MARKET**.

Mercosur is distinguished by unusually strong free trade provisions, dispute settlement procedures and regional institutions. Trade restrictions are eliminated according to a fixed automatic and progressive schedule of trade liberalization (see **LIBERALIZATION OF TRADE**). Final settlement of disputes between members is determined through binding arbitration. The main governing body is comprised of the ministers of foreign and economic relations in each of the member-states, ensuring top political leadership and involvement in the decisions of the trade bloc.

Harmonizing and coordinating macro-economic policy within the bloc will require hard bargaining. A large obstacle to harmonization will be closing the gap between existing economic stabilization programmes in the region (see **STABILIZATION POLICIES**). All the members have taken steps to curb inflation, achieve fiscal balances and open their economies. However, while Argentina, Paraguay and Uruguay have already implemented broad stabilization programmes, Brazil – Mercosur's dominant economy – has taken only modest steps toward **PRIVATIZATION**. Continued progress towards market integration depends largely on Brazil's willingness to expand privatization efforts.

WILLIAM P. AVERY

metatheory

'Metatheory' is a form of rational inquiry concerned with the theory of theory. A metatheory, therefore, is not concerned with explaining a specific social phenomenon in the manner of a substantive theory (like David Ricardo's theory of comparative advantage or Emmanuel Arghiri's theory of unequal exchange). Rather, it is a study of the philosophical and methodological presuppositions

that lie behind a theory – that is, of the taken-for-granted standards about what makes a theory ‘scientific’, including the normative assumptions that legitimate different ethical, ideological or policy positions with respect to what should be done. Three areas of metatheory are of key importance: ontology, epistemology and ethics. Any given theory or approach in the social sciences makes assumptions in these areas. Thus, any standard textbook in NEO-CLASSICAL ECONOMICS typically starts with a ritualistic account of ‘the economic problem’ and ‘the scientific method’, making (1) ontological claims about the nature and significance of different kinds of things in the social world; (2) epistemological claims on what ‘facts’ count as evidence, and (3) ethical assumptions about what are the primary interests of human beings.

One of the key characteristics of CRITICAL THEORY is that it asks metatheoretical questions. Among the range of meanings of the term ‘critical’ is the self-reflexivity of investigators with regard to the presuppositions of their own approaches to the study of society. Thus, critical theory does not abstain from the critique of criticism itself.

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RICARDO DUCHESNE

Mexican peso crisis

Mexico suffered virtual economic collapse in December 1994, when the government – no longer able to sustain its badly overvalued currency – announced a devaluation. The peso crisis was caused by several developments. First, the government overextended its debt obligations by issuing nearly US\$30 billion in short-term treasury notes that would come due in 1995. Second, economic expansion and FREE TRADE had contributed to a growing trade deficit, creating pressure to devalue the peso. Third, the government was slow to act for fear a devaluation might damage its party’s prospects in the forthcoming national election. Finally, these developments (combined with rising INTEREST RATES in the United States) caused jittery foreign investors to dis-invest at the first sign of a weakening peso.

In a short time, the peso fell in value from 29 to 14 cents to the dollar, setting off a 38 per cent decline in the Mexican stock market. The government was hit hard by the stock market plunge, because it had invested most of its foreign aid money in the volatile stock market instead of in new factories and job creation. The government also lost US\$11 billion in just two days in a vain attempt to prop up the peso. However, the impact of the crisis was softened and confined largely to 1995 because of a US\$50 billion rescue package put together by the United States and through the discipline imposed on Mexico by NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) rules. Instead of resorting to import restrictions, NAFTA limited Mexico’s latitude to the adoption of macro-economic measures (for example, tighter fiscal and monetary policy).

WILLIAM P. AVERY

micro-economic policy

Economic theory is really divided into two parts: micro-economics and macro-economics. As their names would suggest, the difference between them lies in the level of aggregation at

which economic phenomena are studied. In particular, micro-economics is concerned with the study of the individual decision units in an economy (that is, consumers and firms) and offers a detailed analysis of individual decisions regarding particular commodities. This also involves examining the way in which the decisions made by consumers and firms interrelate, in order to determine the relative prices for goods and factors of production, and the quantities of these goods that will then be bought and sold. For example, a micro-economist might examine the reasons that individual households prefer cars to motorcycles, and the way in which producers decide whether to produce cars or motorcycles. The behaviour of all individuals and households can then be aggregated in order to determine the nature of total car purchases and total car production. The ultimate aim of micro-economics, then, is to understand the mechanism by which the total amount of resources possessed by society is allocated among alternative uses. This aim is taken to its logical conclusion in the branch of micro-economics known as GENERAL EQUILIBRIUM theory, which simultaneously studies every market for every commodity. In taking such an approach, it is hoped that the entire pattern of consumption, production and exchange in the whole economy at a particular point in time can be analysed.

The central concept in micro-economics is the market. Since the essential elements in a market are the behaviour of buyers, the behaviour of sellers and the ways in which these interact, the study of markets is normally organized into three subtheories. First, there is the theory of the behaviour of buyers – also known as the theory of demand. Second, there is the theory of the behaviour of sellers – or the theory of supply; the so-called ‘theory of the firm’ plays a central role in this. Finally, there is the theory of market behaviour – which examines how prices are determined by the interaction of buyers and sellers in various states of the environment.

A significant feature of micro-economics is the role of the government and the way in

which they implement micro-economic policies, often as a way of mitigating perceived imperfections in the market. The traditional view of government economic policy is that the government is a passive agent that intervenes only in order to correct what are seen as clearly identified shortcomings in the market. More recently, economists have become increasingly aware that this view of government leaves much observed behaviour unexplained. A lot of analysis has therefore been devoted to the issue of the economic rationale that exists for government economic activity. For example, many of the economic reasons for government intervention come under the heading of increasing the efficiency of the market system.

The alleviation of market imperfections is a major goal of interventions. Where cost conditions make it possible, MONOPOLIES are broken up. Where costs conditions create natural monopolies, these are regulated as to the price they can charge and the profits they can earn (or else they are nationalized). Labour mobility can be enhanced by providing information, by subsidizing relocation and by retraining. Kinds of intervention to set minimum standards of quality, ensure correct information and to prevent fraud come under the general classification of compensating for market imperfections.

The central authorities, then, have three main tools: (1) rules and REGULATION, (2) taxation and (3) expenditure. In terms of rules and regulation, various prohibitions and prescriptions on behaviour govern the majority of business practices. For example, in many countries agreements between oligopolistic firms (see OLIGOPOLY) that are designed to fix prices or divide up markets are deemed illegal and the mere existence of monopoly is also regularly prohibited, as a consequence of which monopolistic firms are often broken up into independent competing firms. Moreover, when the cost advantages of monopoly resulting from scale economies are considerable (see ECONOMIES OF SCALE), the prices a monopolistic firm can charge and the return it can earn on its capital investment are often regulated. Nevertheless, there is substantial debate regarding the advisability and effectiveness of

Microsoft

government intervention in the market in such a manner.

The use of taxation is of great significance to the pursuit of many government policies in an economy. Taxation provides the funds to finance expenditure, as well as being useful for a wide range of other purposes, including altering the distribution of income. This can be quite general in its effects, or much more specific and localized.

Finally, with regard to expenditure policies, some government expenditures are in return for goods and services that count as part of the current output, creating a claim by the central authorities on the economy's resources. When the government then purchases factors of production to produce goods and services in the public sector of an economy, the factors are then unavailable to produce output in the private sector. Using expenditure in such a way enables the government to fill in any gaps in what the free market provides, such as the provision of collective consumption goods like national defence. The problem remains with such goods, however, that some individuals will 'free-ride' on their provision (see FREE RIDER PROBLEM). The remainder of government expenditure consists of payments for which no contribution to current output is made in return. These include old-age pensions and welfare payments, and represent a transfer of the power to purchase output from those that provide the money (normally taxpayers) to those that receive it.

See also:

macro-economic policy

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ALISON M.S. WATSON

Microsoft

Microsoft is the quintessential post-industrial company: its capitalization reflects its brand and knowledge resources, rather than its material assets. Having established its operating system as standard on all IBM-model personal computers in the early 1980s, Microsoft benefited from the subsequent proliferation of IBM 'clone' hardware manufacturers. This wide diffusion of Microsoft's operating system laid the foundation for its market dominance in the 1990s, when the Windows user interface became ubiquitous throughout the world. Frequently accused of monopolistic practices regarding its domination of the software industry, Microsoft has defended its position through the aggressive updating of its products and the inclusion of competing software tools as standard elements of Windows.

See also:

informatics; knowledge industries

CHRISTOPHER MAY

Middle East and North Africa (MENA) economic summits

The first Middle East and North Africa (MENA) economic summit was held in Casablanca, Morocco, at the end of October 1994. The aim of this summit meeting was to bring together political and business leaders from the Middle East and the international community, in order to encourage the private sector to play a more prominent role in promoting regional economic cooperation and to support the

Middle East peace process. The MENA economic summits have become an annual event, having been held in Amman, Jordan (1995); Cairo, Egypt (1996), and Doha, Qatar (1997). The stalemate in the peace process between Israel and the Palestinians in 1998 placed the continuation of these meetings in doubt, however, and no date and venue has yet been set for future meetings.

JOEL PETERS

Middle East Regional Development Bank

The idea of establishing a Middle East Regional Development Bank was first raised at the MIDDLE EAST AND NORTH AFRICA (MENA) ECONOMIC SUMMIT in October 1994. The idea did not receive universal support. Many members of the European Union (EU) and the Arab Gulf states expressed reservations over the need to create a new financial institution in the Middle East. Despite these concerns, the articles of the new bank, which would be located in Cairo, were registered with the United Nations (UN) on the 26 August 1996. It was agreed that the initial capitalization of the bank would be US\$5 billion and that Israel, Egypt, Jordan and the Palestinian Authority, as the regional partners in the bank, would control 4 per cent of its equity. However, it has proved difficult to secure the necessary capital for the bank. The US Congress has, in particular, been unwilling to release any funding for the bank. With the virtual stalemate in the Middle East peace process in 1998, the establishment of a Middle East Regional Development Bank has, so far, not been realized.

JOEL PETERS

migration, international

In the widest sense, 'international migration' refers to all forms of cross-border mobility of

people. In a stricter sense, 'international' migration occurs when people move from one 'nation-state' to another. In the modern era, six forms of migration are of particular importance: the slave trade, refugee migration, colonization, industrial labour migration, (post-)colonial migration and illegal migration.

In the period between 1500 and 1800 (the era of MERCANTILISM), there were three major waves of migration, each in their own way constitutive of the contemporary global political economy. In Western Europe, the formation of nation-states and the rise of capital were accompanied by large-scale refugee movements (primarily of Jews and Protestants, from the Iberian Peninsula and France to England and the Low Countries) and by the modest outflow of colonists to the Americas. Labour migration in this era took the form of the transportation of millions of slaves from the African coasts to the Americas.

In the era of the INDUSTRIAL REVOLUTION (1800–70), colonization through emigration became the main mode of expansion of capitalist relations, creating new markets for the emerging industries in Europe. Industrial growth centres in Europe attracted foreign migrant labour (Irish in England, Poles in Germany, Italians in France and Belgium).

The age of IMPERIALISM (1870–1914) brought the abolition of slavery and the further integration of peripheral areas into the world economy. The resulting shortage of labour was relieved by importing contract labourers from Asia into the Caribbean plantation economies, as well as several other regions. The colonizing migration to North America gradually changed, both in terms of countries of origin (shifting from Western Europe to southern and eastern Europe) and in terms of its nature: after the Civil War, the new immigrants were absorbed by the rapidly expanding manufacturing industry in the north-east. The continuous shortage of labour led also to the active recruitment of temporary Mexican workers between 1900 and 1929.

The Interbellum (1919–39) began with massive refugee movements resulting from the dissolution of the Russian, Ottoman and

Austro-Hungarian Empires. The decade of the 1930s was dominated by the world economic depression (see GREAT DEPRESSION) and by the closure of national economies: across the board, industrial countries discouraged immigration and even actively promoted the repatriation of foreign workers.

In the three decades after World War II, four types of migration can be discerned. First, from 1942 in the United States and from 1945 in several West European countries, labour shortages led to the organized recruitment of temporary industrial labour abroad: the GUEST WORKER SYSTEM. Second, the post-war period was characterized by large-scale movements of displaced persons and REFUGEES. Third, there was a new wave of colonizing migration from Western Europe to North America, South Africa and Australia/New Zealand. Finally, DECOLONIZATION produced both enormous flows of refugees (as between Pakistan and India) and large-scale migrations from (former) colonies to the metropolitan countries (primarily France, the Netherlands and the United Kingdom).

With the rise of new growth poles in the world economy, migratory movements also found new destinations. In the late 1970s and early 1980s, oil-exporting countries (particularly those in the Middle East) recruited large numbers of migrant workers – not only in the oil industry, but also as domestic workers and professionals – both from the region and from Asia. During the 1990s, the Asian Tigers (see FOUR TIGERS (ASIAN)) attracted millions of migrant workers from countries in South and South-East Asia, as well as from China. This migration was (probably only temporarily) reversed by the ASIAN CRISIS. Finally, migration to the industrial countries continued during the 1970s and early 1980s, primarily through family reunification. From the mid-1980s, immigration to North America, Western Europe and, to some extent, Japan accelerated as the result of the deteriorating economic, political and social conditions in large parts of the THIRD WORLD, as well as in Eastern Europe and the former Soviet Union. This new migration took place either as refugee

migration or as illegal migration. The increasingly restrictive policies of the receiving countries played into the hands of organized crime, which took control of the trafficking of people into the European Union (EU) and North America.

By the end of the 1990s, more than 120 million people (or 2 per cent of the world's population) reside outside their country of birth.

See also:

criminal economy; International Organization for Migration (IOM); refugees

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HENK OVERBEEK

MILITARY KEYNESIANISM see Keynesianism, military

military-industrial complex (MIC)

The 'military-industrial complex' (MIC) refers to the alleged close and friendly ties between the military services, civilian defence officials and the private ARMS INDUSTRY. Lines of authority between public and private entities are blurred, and national security policy may be captured to benefit selective interests rather than the general welfare. The phrase originated in US President Dwight Eisenhower's 1961 farewell address, in which he urged US leaders to balance investment in guns and butter – that is, to remain vigilant against the pressures of the MIC, which might lead to a militarization of the economy and society. Of course, many politicians before Eisenhower had also attacked the power of military and defence industry interests – they railed, for example, against 'merchants of death' in the 1920s and 1930s. Academic discussions of the MIC theory flourished in the 1960s and early 1970s, and the theory's implications now suffuse journalistic coverage of defence policy. Recent academic treatments of the theory that the MIC has undue influence have generally been less favourable than the earlier literature.

Only a few of the authors writing on the MIC have addressed its effect on foreign policy choices. Their discussion extends pluralist, power elite and Marxist theories of IMPERIALISM. From this perspective, the MIC should just be treated as a particularly powerful interest group, with close ties to the policy-making elite which facilitate its control of foreign policy.

Meanwhile, the bulk of the MIC studies deal with the effects of close military-industry ties on civil military relations and especially on defence procurement. The MIC ultimately describes a particular kind of business-customer relationship: a bilateral OLIGOPOLY situation in which a few arms manufacturers negotiate contracts with a small group of government officials, who themselves are divided between military and civilian organizations. Normally, customer relationships involve

a conflict of interests between buyers – who prefer low prices and high quality (generally meaning high costs) – and sellers – who prefer high prices and low quality (minimizing production cost for products of a given price). Buyer-seller relationships between the government and private firms might be especially acrimonious due to the requirement that they cross the boundary between the STATE and CIVIL SOCIETY. The military, in particular, is widely reputed to disdain cost benefit analysis (widely used in commercial industry) in favour of worst-case-scenario planning, with the goal of maximizing security rather than wealth. One argument about the pernicious effects of the MIC suggests that cooperation between military officers and private defence firms degrades military professionalism by teaching soldiers non-military values.

Similarly, tensions are built into government decision-making on national security affairs: between military leaders (who are concerned with security) and civilian officials (who are attuned to other resource demands on the modern state – for example, the WELFARE STATE). The MIC is alleged to weaken civilian control of the military by adding powerful corporate interests to the political punch of the military's claim of expert knowledge about vital national security affairs. Independent civilian defence expertise may be too weak to compete with growing military staff resources. Civilian posts in the Office of the Secretary of Defence and on Congressional staffs are increasingly filled by seconded or retired military officers. If private defence interests ally politically with military officers, pressures on government civilians to outsource or privatize planning and contract monitoring tasks may further strengthen the MIC.

Contrary to the normal presumption of conflicts of interest between military officers, civilian leaders and private arms manufacturers, the MIC theory argues that the three groups collude to further their joint interests against those of the rest of society. The MIC theory of procurement is most clearly stated as James Kurth's 'follow-on imperative' (see Kurth, 1989). Kurth argues that Pentagon

military-industrial complex (MIC)

civilians specifically created new jobs for prime contractors as they neared the completion of previous projects. Maintaining continuity of projects helped ensure stable employment (attracting legislative support for the Department of Defense budget and agenda) and satisfied the desire of the uniformed military for a steady supply of expensive, innovative weapons. Costs were imposed on diffuse, difficult to organize taxpayers.

The MIC theory is alleged to operate via one or both of two transmission mechanisms. First, because defence firms locate plants in key Congressional districts, they may gain political influence on the defence budget by directing expenditures to constituents' salaries. But it has proven difficult to identify 'key' districts: for example, the districts of members of Congress who sit on defence-oriented committees do not receive a disproportionate share of defence expenditures. Alternatively, if all legislators vote on defence bills based on district employment concerns (not just key legislators), the arms industry's distribution of subcontracts to every Congressional districts might make defence contracts unstoppable political juggernauts. Again, however, regression studies of Congressional voting patterns do not reveal a correlation between in-district defence spending and a propensity to vote for procurement programmes. Even with the efforts to spread subcontracts, spending for most defence programmes is concentrated in only a few districts. In general, subcontracts are insignificant compared to the size of the district economy, and it should be no surprise that they do not influence legislators' votes.

Instead of exploiting legislative institutions, contractors might exploit their near monopoly on technical information to influence military requirements in favour of their products. This argument formally or informally applies the 'incentive theory of regulation' to the defence sector. Contractors, who conduct the bulk of military research and development (R&D), have much more information on technical possibilities for new weapons than government procurement officials have, which gives the defence firms a substantial advantage in con-

tract negotiations. To minimize the risk of a programme failure (which might reflect badly on the military or on civilian defence officials), contracting officers may favour established companies. In cases of cost over-runs and performance failures that threaten the financial health of major arms suppliers, contracting officers allegedly subsidize their suppliers. The crucial link holds that bureaucrats are so dependent on their stable of arms manufacturers that even poor production performance will be overlooked in contract re-negotiation and in the award of future contracts. However, many COLD WAR defence firms failed to receive follow-on projects and their demise contradicts this basic MIC model. As examples, Fairchild, Republic, Ryan, Rockwell, Vought, Martin and Curtiss-Wright all used to build military aircraft, but none is a prime contractor today.

A repaired MIC model might account for the pattern in which most business-government relations in the defence sector are stable, while some firms and projects fail. If a company ignores its political relationship to its customers, thereby giving up its influence on contracting outcomes, then that company's collapse can be reconciled with the MIC theory. But it is difficult to believe that a major defence firm could ever 'forget' the political nature of its customer. Alternatively, if a company were excluded from the MIC's political coalition by the souring of its relationship with other members of the defence industry oligopoly, the company's collapse might also be reconciled with the theory. The MIC should only be expected to protect members of a powerful, winning coalition. Additional empirical work needs to be done on intra-industry relationships to supplement the economists' models of the competitive behaviour of regulated oligopolists in the arms industry.

See also:

arms trade; conversion of arms industry

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EUGENE GHOLZ

Mill, J(ohn) S(tuart) (1806-73)

J.S. Mill's major contribution to international trade is his 'great chapter', contained in *Political Economy* (1920: chap. 18), much of which was directly reprinted from Mill (1844) although it was first written in 1829. Edgeworth (1925: vol. 2, p. 20) described this as 'stupendous' and O'Brien (1975: 183) judged it to be 'one of the greatest performances in the history of economics'. This chapter is famous for exploring the role of 'reciprocal demand and supply' in the determination of the TERMS OF TRADE between the comparative cost ratios of two countries. Mill was able to explore the importance of reciprocal demand much more clearly than previous writers because of his conception of demand as a schedule (see Mill, 1920: 585). This feature was stressed by Robbins (1958: 242), when comparing his trade analysis with that of Torrens, and by O'Brien (1975: 183). Despite the importance of Torrens' and Pennington's work, Viner (1955: 447) emphasized the pivotal role of Mill's analysis for subsequent work. Although Pennington referred to the strength of demand when examining the gains from trade, he suggested (1840: 36, 39, 40-1) that the exchange rate fluctuates between extremes, rather than tending to some determinate value. Mill did not use mathematical notation, preferring to give numerical examples.

In Mill's analysis, England is assumed to have a COMPARATIVE ADVANTAGE over Germany in the production of cloth, while Germany has a comparative advantage in linen production. England has a demand for linen that depends on its price relative to that of cloth, which can be expressed in terms of an amount of cloth per unit of linen. This is the basis of Mill's argument that 'all trade is in

reality barter, money being a mere instrument for exchanging things' (Mill, 1920: 583). If England demands a certain quantity of linen, there is a reciprocal supply of cloth equal to the amount of linen multiplied by the relative price. Neglecting transport costs, equilibrium requires that the post-trade relative price is the same in each country and that the price is such that Germany's import demand for cloth precisely matches England's export supply. After giving a numerical example, Mill added that 'as the inclinations and circumstances of consumers cannot be reduced to any rule, so neither can the proportions in which the two commodities will be interchanged' (ibid.: 587).

Mill then went on, when considering the gains from trade, to add that 'the circumstances on which the proportionate share of each country more remotely depends, admit only of a very general indication' (ibid: 587). It is in Mill's subsequent discussion of such 'general indications', that he used the concept of demand elasticity – although he described it with the term 'susceptibility'. Mill effectively argued (ibid.: 587–8) that if the German demand for cloth is completely inelastic, then all the gains from trade go to Germany. In general, Mill was able to demonstrate that:

If, therefore, it be asked what country draws to itself the greatest share of the advantage of any trade it carries on, the answer is, the country for whose production there is in other countries the greatest demand, and a demand the most susceptible of increase from additional cheapness.

(ibid.: 591)

Mill also introduced additional countries, transport costs and additional goods, as well as examining the effects of technological change and shifts in demand (for further discussion of Mill and his critics, see Creedy, 1990).

Whewell (1850) produced a mathematical version of Mill's analysis and gave an expression from which the terms of trade can be obtained in terms of the two demand elasticities and the demands (see Creedy, 1989). It is likely that Whewell's results provided the major impetus for Mill's supplementary sections,

added in a later edition. Mill's discussion of the limits within which his 'equation' applied, his recognition of partial specialization, his emphasis on the domestic transfer of resources and his treatment of inelastic, unitary and elastic demands probably came from Whewell (see, in particular, Mill, 1920: 598). Chipman (1965) interpreted Mill as assuming constant unit elasticities of demand, but was strongly criticized by Appleyard and Ingram (1979). Mill's 'great chapter' continues to provide much interest.

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JOHN CREEDY

minimalism (political)

The term ‘minimalism’ refers to minimal political involvement in society, generally being restricted to issues of law and order and to ensuring the freedom of individuals. Economics should largely be left to market forces. Excessive political involvement in society is seen by minimalists as restrictive to individuals; this view ignores ideas of positive liberty.

See also:

liberalism

LYN JAGGARD

Ministry of International Trade and Industry (MITI)

The Ministry of International Trade and Industry (MITI) has been placed at the centre of many of the most influential accounts of Japan’s post-war economic development, especially those which have emphasized the role of the DEVELOPMENTAL STATE in providing administrative guidance to Japanese industry (Johnson, 1982). Ostensibly a post-war institution, established in 1949, MITI was actually the product of a re-organization of the Ministry of Commerce and Industry, which had been created in 1925 and was itself temporarily transformed into the Ministry of Munitions in 1943.

Chalmers Johnson’s seminal history of Japan’s industrial policy has identified the importance of MITI’s role as a pilot organization, staffed by a small, inexpensive but elite bureaucracy, in the perfection of market-

conforming methods of state intervention in the Japanese economy (Johnson, 1982: 315–20). However, more recent analyses of Japanese industrial policy have tended to question the salience given to MITI’s administrative guidance in explanations of Japan’s economic development. For example, Scott Callon’s analysis of high-technology industrial policy in Japan has identified clear limits to the influence and effectiveness of MITI’s interventions. Callon’s thesis is that the positive effects of state intervention and MITI’s bureaucratic power have been overemphasized, while the pluralism in the Japanese political economy (specifically the fighting within and between the state bureaucracy and Japan’s transnational corporations) has been insufficiently acknowledged (Callon, 1995: 201–2).

See also:

Asian corporatism (AC); Confucian model of development; East Asian model; Japanese model

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SIMON LEE

Minsky, Hyman P(hilip) (1919–96)

Best known as a dissenter from mainstream macro-economics, Hyman Minsky traced his intellectual influence primarily to University of

Chicago's Oscar Lange, Paul Douglas, JACOB VINER, Frank Knight and Henry Simons (and to Harvard University's JOSEPH SCHUMPETER), rather than to the Harvard Keynesians. As he would later argue, 'the neo-classical way of doing economics, which rests upon splitting the financial system off from what is called the real economy, throws no appreciable light on the effect that a financial system has upon the functioning of the economy: the only relevant neo-classical position is that the financial structure makes no difference' (Minsky, 1992b: 15). In contrast, Minsky's approach always concerned what he claimed to be the primary features of our modern capitalist economy: financed positions in long-lived, expensive and primarily owned capital assets in a for-profit economy.

Hyman ('Hy') Minsky was born in Chicago and attended public schools in Ohio, Chicago and New York, before entering the University of Chicago in 1937 to study mathematics. Growing up in a working-class family with strong socialist leanings, Minsky was drawn to economics, especially after taking the integrated social science sequence course and the classes and seminars taught by Lange, Knight and Simons at Chicago. He developed a particularly close relationship with Gerhard Meyer, whose influence played a pivotal role in Minsky's decision to further his economics education in graduate school. His graduate work was completed at Harvard, having been interrupted by a good number of years in the US Army, including assignments in New York and overseas during the mid-1940s. The ideas involving the interrelationships between market structure, banking, aggregate demand and business cycles, first put forth in his PhD dissertation in 1954, became the core of his lifelong research programme (Minsky, 1985; Papadimitriou, 1992).

Following the Harvard years, 'Hy' Minsky began his academic career first in the economics department at Brown University (1949–55), then moving to the University of California at Berkeley (1956–65) and later to Washington University in St Louis (1965–90), before taking up the post of Distinguished Scholar at the

Jerome Levy Economics Institute of Bard College which he occupied until his death.

His earliest writings 'endogenized' FINANCIAL INNOVATION, introduced institutional 'ceilings and floors' to the multiplier–accelerator model (see ACCELERATOR PRINCIPLE; MULTIPLIER PRINCIPLE) and included financial positions as 'initial conditions' that would influence the path of the economy, building the theoretical basis for his argument that the United States emerged from World War II with 'robust' balance sheets that over time would become increasingly fragile, generating the conditions that might make 'It' (a debt deflation such as that which occurred in the 1930s) happen again (Minsky, 1957a; 1957b; 1959). Thus, even his earliest analysis deviated from conventional macro-economics by addressing 'endogenous' money, innovation that stretches liquidity, behavioural changes induced by policy (foreshadowing the RATIONAL EXPECTATIONS paradigm), LENDER OF LAST RESORT doctrine and market-driven, instability-enhancing behaviour over the course of the BUSINESS CYCLE (Papadimitriou and Wray, 1998). These conceptions continued through much of his work during the 1960s, when he developed his 'financial instability hypothesis' (FIH) in addition to focusing his attention on a detailed examination of the actual operation of financial markets and institutions (Minsky, 1963a; 1965; 1969; 1972).

Minsky's *John Maynard Keynes* (1975) developed his 'financial theory of investment and investment theory of the cycle'. While some have argued that the title of his book was misleading, Minsky borrowed from Keynes the notions that investment is undertaken on expectations of future profit, that asset prices reflect these expectations but they must take into consideration 'lenders' risk' and 'borrowers' risk', and that investment is the driving variable of the macro-economy. He argued that in any capitalist economy there are two important price systems, one for current output and the other for asset prices (the former of which is solely the most important according to the mainstream, while the latter is almost wholly ignored), and it is the interplay between

these two sets of prices which causes economic fluctuations. When expectations are high, the demand price for capital assets (adjusted by the borrower's risk) is high in relation to the current output price of capital (adjusted by the lender's risk) inducing investment and generating growth. Investment spending, in turn, is a primary determinant of aggregate profit flows which ultimately validate the optimistic expectations. This fuels more optimism, reducing lenders' and borrowers' risks, inducing entrepreneurs to lower margins of safety until expectations are revised or disappointed. As soon as aggregate investment spending falls, profit flows are reduced, so that past investment decisions are not validated. Minsky would outline his view as the proposition that investment today will occur only if more investment is expected in the future, because aggregate profits will not exist unless investment re-occurs.

An obvious connection exists between Minsky's theory of investment and his FIH (Minsky, 1963a; 1978; 1980). In the early stage of the expansion, balance sheets are 'robust' or 'hedge', with income flows exceeding cash commitments (including payment of interest and principal on debt) leaving a margin of safety. As investment spending increases, profits are incurred which encourage greater risk-taking through reduction of the margin of safety. Some entrepreneurs choose to undertake 'speculative' positions in which near-term income flows are sufficient to cover only the interest commitments, but not the principal on the debt, so that short-term debt must be 'rolled over'. These speculative business units anticipate that short-term finance will continue to be available (without significantly rising costs) and eventually income flows will increase, thus enabling them to repay principal with a net profit remaining. Over time, then, the financial arrangements become increasingly 'fragile' as the burden of speculative positions grows in relation to hedge positions. If cash flows decline when a reduction of aggregate investment occurs, if finance is disrupted (either due to a 'credit crunch' or to higher short-term interest rates) or, finally, if expecta-

tions are suddenly revised downwards (so that firms try to increase margins of safety by scaling down projects or selling assets), then speculative positions can be pushed to 'Ponzi' positions in which cash flows cannot even cover interest, let alone principal, so that interest must also be 'rolled over'. Under these circumstances, financial arrangements are further disrupted since financial institutions normally do not become lenders to Ponzi schemes.

Minsky's *Stabilizing an Unstable Economy* (1986) offered a detailed examination of policy interventions that could attenuate this instability. Returning to the themes of the research programme he first undertook in the 1950s, Minsky argued that the two most important stabilizers are the 'ceilings' and 'floors' of counter-cyclical fiscal policy and central bank 'lender of last resort' interventions. Counter-cyclical deficits place ceilings and floors on aggregate profit flows – deficits generate profits while surpluses absorb them – thus automatic stabilizers that cause the budget to move to deficit in recession and surplus in expansion should be strengthened. Central bank lender of last resort activity places a floor on asset prices since lending is an alternative to forced fire-sales of assets by cash-strapped financial and non-financial institutions. Minsky realized, however, that both of these types of intervention may lead to MORAL HAZARD by encouraging reduction of margins of safety and increased financial fragility. He therefore advocated greater use of the 'discount window' with increased supervision and correspondingly reduced provision of reserves through open market operations. He also suggested other policies that would favour small- to medium-sized banks and firms to ensure that none would be 'too big to fail'. Consequently, fiscal and central bank intervention would 'save' the system, to prevent 'It' from happening again, but would allow individual banks and firms to fail to maintain market discipline.

During the last years of his life, Minsky argued that modern capitalism had entered a new stage, dubbed 'money manager capitalism' (Minsky, 1995; 1996; Minsky and Whalen,

1996). The relative stable growth and absence of debt deflations in the post-war period – excepting the recent instability in Asia and Japan – allowed the development of huge portfolios of financial instruments for accumulated pensions, distributed profits, personal financial wealth and retained earnings. As Minsky put it:

Capitalism in the United States is now in a new stage, ‘money manager’ capitalism, in which the proximate owners of a vast proportion of financial instruments are mutual and pension funds.

(Minsky, 1996: 358)

The values of portfolios are daily ‘marked to market’, forcing a short-range horizon on managers, who have ‘become increasingly sensitive to the stock market valuation of their firm’ and thereby greatly increasing uncertainty (Minsky and Whalen, 1996: 5). Minsky’s concern regarding financial instability led him to formulate policy proposals regarding bank regulation, community development banking, tax reform, unemployment and poverty, and the introduction of ‘institutions’ rather than ‘markets’ to the transition economies (Minsky, 1991; 1992a; 1992c; 1995; 1996; Minsky *et al.*, 1993).

Hyman Minsky was a man of ideas, a real world economist, an independent thinker, a persuasive policy advocate, and he has left an indelible mark on macro-economics.

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DIMITRI B. PAPADIMITRIOU

mode of production

The concept of 'mode of production' is central to Marxist theory. In the 'orthodox' version of HISTORICAL MATERIALISM, history is regarded as the succession of different modes of production. In this interpretation, the productive forces are regarded as the driving force of history, and RELATIONS OF PRODUCTION develop on the basis of their functionality to the further development of the former. The productive forces tend to be defined as TECHNOLOGY, while the relations of production are constituted by ownership of the productive

forces. In the capitalist mode, the basic class division is between the bourgeoisie (who own the means of production) and the proletariat (who own nothing but their labour power). Within this perspective, the mode of production or economic base is said to determine the SUPERSTRUCTURE.

This perspective was challenged by the Bolshevik revolution in 1917 and a host of revolutions in the THIRD WORLD following World War II. In each of these cases, revolution occurred in countries where CAPITALISM had only partially developed. Thus there was no simple determinism between mode of production and superstructure, and it appeared that ideology and politics were at least as important as economics in explaining social change.

In the 1960s, French structuralist Marxism attempted to deal with this problem. Louis Althusser argued that rather than the base determining the superstructure, a social formation was composed of three levels – the economic, political and ideological. The economic level, or mode of production, remains 'determinant in the last instance' as it determines which level will be dominant within a particular social formation. The economic level therefore sets limits to the workings of the other relatively autonomous levels, as the latter function in some ways to reproduce the former.

It was this Althusserian approach that was used by many anthropologists and international development theorists in the 1970s. They argued that the impact of capitalism in the Third World was very different from its impact in the core, 'advanced' capitalist countries (see CORE-PERIPHERY MODEL). Rather than destroying the pre-capitalist mode, capitalism articulated with it. In this way, capitalism's reproductive requirements were subsidized by the existence of cheap labour and raw materials that had their origin in the non-capitalist mode.

This approach has been criticized for its ECONOMISM and FUNCTIONALISM. Marxist critics of the structuralist view point out that the notion of a separate economy, be it determinant or determined, is (in Marx's sense) ideological – a form of appearance of capitalist social relations. It is only in a capitalist mode

mode of production

of production that the political STATE appears to become separated from the development of a CIVIL SOCIETY of independent producers. Therefore, the capitalist mode of production cannot refer to a determinant 'economy' so much as to a distinctly modern society (see MODERNITY). A mode of production is therefore not a purely economic category, but is simultaneously composed of economic, political and ideological features. For example, this perspective does not relegate the capitalist state to a derivative superstructure or political level, but instead sees it as a constituent part of the mode of production. Causal relationships are thus derived from a theoretically informed historical approach, rather than on an *a priori* basis – in other words, concepts are themselves historically grounded. The general and ahistorical base-superstructure model is therefore rejected.

The accusation of functionalism clarifies the argument. If capitalism 'chooses' to articulate with non-capitalist modes, then this must be demonstrated empirically rather than assumed. For if an articulation of modes of production occurs in, say, South Africa, then why did it not occur in the United Kingdom? The articulation argument is that this happened also because of the logic of capitalism, even though the outcome in the United Kingdom was the total opposite from the South African case. It is therefore assumed that capitalism automatically secures its conditions of existence, irrespective of the actions of human beings. Like all functionalist approaches, articulation theory's argument is circular, using the same explanation for diametrically opposed historical outcomes.

Alternatively, a minimal definition of the mode of production ensures that a Marxist approach is more sensitive to the contingency, diversity and uncertainty of history. In this way, the (class) struggles of concrete agents are assigned a central place in the understanding of historical dynamics. While the relations and forces of production are the key components of any mode, their constituent elements vary across time and space. Marx's more open-ended definition is particularly useful:

The specific economic form, in which unpaid surplus labour is pumped out of direct producers, determines the relationship of rulers and ruled, as it grows directly out of production itself and, in turn, reacts upon it as a determining element. This does not prevent the same economic basis – the same from the standpoint of its main conditions – due to innumerable different empirical circumstances, natural environment, racial relations, external historical influences, etc., from showing infinite variations and gradations in appearance, which can be ascertained only by analysis of the empirically given circumstances.

(Sayer, 1989: 27–8)

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RAY KIELY

mode of regulation (MoR)

The 'mode of regulation' (MoR) and the 'regime of accumulation' (RoA) are regulation theory's two fundamental concepts (see REGIME OF ACCUMULATION (RoA); REGULATION THEORY). Both are middle-range *intermediate concepts* with an immediate identification with concrete phenomena (Mavroudeas, 1999). They are not generated from a general theory but from empirical observations (*stylized facts*), which are supposed to capture crucial facets of specific historical epochs.

RoA is the form of distribution of surplus between capital and labour required in each period in order to coordinate production with social demand. It covers the essential economic conditions (technology, labour-process organization, relations between the departments of production) for the operation of the system and is posited at the level of compulsory economic structures. MoR designates the necessary institutional forms and social compromises for the reproduction of the regime and it is less determinate, since it relies on historically specific institutional forms. Each RoA is compatible with many modes. Which will prevail is a question open to the indeterminacy of history.

Regulation recognizes two modes. In the *competitive* MoR – being more appropriate for the extensive RoA – the output was adjusted a posteriori to price movements (which were tagged after changes in demand) and wages followed price movements (hence, real wages were either stable or rose slowly). In the *monopolist* MoR, income distribution is socialized via a series of compromises between capital and labour (wages follow inflation and productivity). Market coordination of social demand with production plays a minor role. Coordination is exercised by a complex set of institutions, which develop constantly effective demand at the rate of production capacities.

Aglietta's (1979: published in French in 1974) initial formulation of the relationship between RoA and MoR accepted the primacy of economic relations over their political and

institutional counterparts. The law of accumulation (the more abstract economic dimension) determined RoA (the historically specific dimension), which was supported by MoR (its politico-economic institutional counterpart). In CEPREMAP-CORDES (1977), the first concept was discarded and the relationship between the last two concepts was relativized, with the rejection of their one-to-one mapping. More than one MoR can correspond to an RoA and the former achieved a greater degree of freedom from the latter. For regulation's initial formulations, MoR was the economic-cum-institutional meso-periodic basis of social hegemony. It was not strictly economic since this area was covered by the longer long-run concept of accumulation and by the long-run concept of RoA. It was not purely contingent since it encompassed meso-periodic economic and institutional variables or 'regularities'. In contrast to RoA, it also covered ideological and political factors. It was also dynamic, since historical contingency could lead to several MoRs being employed successively by a RoA. Hence, it was founded simultaneously on the (economic plus institutional) structural level and on the individual 'subjective' level (habits, individual actions of the agents and so on). In later formulations (for example, Lipietz, 1988), MoR was posited almost exclusively as the realm of politics. Thus it became even more historically concrete and was almost totally autonomized from RoA.

See also:

Fordism: mode of regulation; Fordism: regime of accumulation

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STAVROS D. MAVROUDEAS

modernity

'Modernity' is currently the most popular concept derived from the idea of 'being modern'; its lineage can be traced through 'modernism' in the early twentieth century and 'modernization' in the mid-twentieth century. Although each of very different provenance – being (chronologically) an arts movement, positivist sociology and the recent 'cultural turn' in social studies – this cluster of concepts express a common fascination with rapid social change, usually equated historically with the era of industrialization. Although the modernists' attempts to 'capture' change on their canvasses and in their architecture, and the modernizers' attempts to 'control' change through their social theory in development planning, have both proved to be massive social failures from the point of view of their victims (those, for example, forced to live in tower blocks in rich countries or forced off their land in poor countries), scholars have been reluctant to abandon concern for being modern: hence the contemporary popularity of studies of modernity as 'both so irresistible and so problematic a category' (Osborne, 1996: 348).

To a degree, modernity has replaced CAPITALISM as the prime concept in contemporary social analysis; this is largely because it is thought to provide a better framework for understanding cultural experience (for example, Wilson, 1987). The result is that 'in these otherwise antitotalising times it is the one totalisation that is still allowed' (Ogborn, 1998:

3). This has been possible because of an abrupt epistemological break from MODERNIZATION THEORY and its provision of an ordered blueprint for how DEVELOPING COUNTRIES should plan their futures: the certainty of modernization has been replaced by the ambiguity of modernity. The key text that began the new way of conceptualizing being modern was Marshall Berman's *All that is Solid Melts into Air* (1988, first published in 1982). The title is a quote from MARX which epitomizes the break from modernization: Marx is no longer seen as a belligerent figure in the COLD WAR contest for the future, but instead is rediscovered as a great social scientist grappling with the problem of understanding incessant social change.

According to Berman, to live in the modern world is to experience 'a maelstrom of perpetual disintegration and renewal, of struggle and contradiction, of ambiguity and anguish' (Berman, 1988: 15). In short, modernity is simultaneously promise and threat. Subsequent studies have conceptualized the 'two sides of modernity' (Lash and Friedman, 1992: 2) in slightly different ways. For instance, Wagner (1994: xii) focuses on the 'double notion' of liberty and discipline, Santos (1995: 2) defines the two 'pillars' of modernity as regulation and emancipation, and Bauman (1991: 4, emphasis in original) argues that 'order and chaos are modern twins'. In practical terms this reduces to ordinary men and women striving to become subjects of history rather than its objects. Thus, for Berman, the revolutions of 1989 are interpreted as the peoples of Eastern Europe 'all trying to make the modern world their own' (Berman, 1992: 55).

Faced with this modern maelstrom, powerful people and their institutions have invented numerous planning projects in attempts to 'control' change. Imbued with an optimism built on a belief in progress, these modern elites have invariably under-estimated their task. If, indeed, 'all that is solid melts into air' then plans once hatched immediately become wanting and fall into a routine of necessary adaptation to change, an activity which gets progressively more difficult. In recent years all of the following have fallen victim to moder-

nity's penchant for disintegration: Keynesian economic planning, Soviet socialist planning, Third World development planning, Fordist corporate planning, welfare state planning, Cold War military planning, and urban land-use planning (Taylor, 1999: 18). This contemporary cull is commonly associated with GLOBALIZATION as the culmination of the modern maelstrom (Appadurai, 1996; Giddens, 1990).

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PETER J. TAYLOR

modernization theory

'Modernization theory' is a form of economic and social theory that seeks to conceptualize the processes of change occurring in traditional or undeveloped societies as they move in the direction of a more complex DIVISION OF LABOUR and more elaborate patterns of social and political organization. It is usually associated with an 'evolutionary' view of the social, economic and cultural transition between two IDEAL TYPES of society/economy: the traditional and the modern. The task of such a theory is to conceptualize the key factors underlying the process of social differentiation and the reorientation to economic and social action that facilitate this transition. Most modernization theorists assume that the modernization process is one that follows a definite set of specifiable historical laws, and that (in principle) all pre-modern societies can follow in the footsteps of those societies that have already traversed the road to MODERNITY. The theme of modernization is also to be found in the Marxist theoretical tradition, but here it occupies a decidedly secondary status in relation to the concept of social revolution, while at the same time constituting a source of both theoretical and political controversy among Marxists.

It would not be an exaggeration to say that the problematic of modernization was at the very centre of the development of early modern social theory. From the enlightenment of the 1700s up to the early years of the twentieth century, the nature of the 'great transformation' that was fundamentally reshaping European society was a major preoccupation of all of the emerging social sciences. ADAM SMITH wrote of the transition from an 'agricultural' to a 'commercial' market-based society; Herbert Spencer wrote of the transition from 'militant' to 'industrial society'; Emile Durkheim wrote of the movement from mechanical to organic solidarity, and Ferdinand Tönnies wrote of the shift from *gemeinschaft* (community) to *gesellschaft* (societal association). In one of the more enduringly influential (and pessimistic)

formulations of this era, MAX WEBER described the triumph of a world-historical process of rationalization that had catapulted European society from traditional forms of economy and 'domination' to the modern capitalist ones that were rapidly enclosing civilization in a soulless 'iron-cage' of rational-legal bureaucracy and instrumental rationality. While similarly recognizing the increase in human ALIENATION brought about by the transition from FEUDALISM to the capitalist MODE OF PRODUCTION, KARL MARX saw the triumph of capitalist modernity as laying the material basis for a new society that would be free of class antagonism. For Marx, the future communist society would not simply be a different version of modernity, but the beginning of a truly human civilization.

Twentieth-century modernization theory

In the twentieth century, modernization theory was most closely associated with the academic discipline of sociology and in particular with sociological functionalism. Building on Weber's ideal-type distinction between traditional and modern orientations to social and economic action, Talcott Parsons delineated a series of 'pattern variables' to distinguish between traditional and modern social forms. For example, in traditional societies, behaviour tends to be 'affective' (emotionally charged), whereas in modern ones, 'affective neutrality' is the norm. The process of modernization is both promoted and characterized by a shift from the traditional set of forms to the modern one: affectivity gives place to affective neutrality; ascribed statuses to achieved ones; diffusion to specificity; particularism to universalism, and an orientation towards collective interests gives way to an orientation towards private interests. In defining his pattern variables in this way, Parsons took his own mid-twentieth-century US society as the exemplar of modern society. Indeed, for functionalist modernization theory in general, the US model of society – democratic, industrial, individualistic and capitalist – is viewed as the final goal towards which the process of

modernization, conceived as a unitary direction of change, must unfold.

The key theme of functionalist modernization theories has been 'structural differentiation' – the 'horizontal' process of increasing functional specialization and separation of social roles and collectivities that are becoming both more formally autonomous and materially interdependent. Structural differentiation allows for the emergence of a more productive and wealthy society, but one which must also confront the Durkheimian problem of 'anomie' – the deficit of moral and normative regulation that undermines social harmony and solidarity as a traditional 'collective consciousness' gives way to a 'cult of the individual' nurtured by an ever more complex division of labour. Modernization, to be successful, must steer a successful course between the goal of increased economic efficiency and the requirements of socio-cultural 'reintegration'.

The most influential economic theory of modernization is that of W.W. ROSTOW, who specifies a set of 'stages of economic growth' (see STAGES OF GROWTH). Like the sociological-functional theories of modernization, Rostow's account assumes that all societies have the potential to become advanced industrial, capitalist societies, and that to realize this potential contemporary 'developing societies' must follow the evolutionary path blazed in the past by countries like the United Kingdom and the United States. All societies may be identified in their 'economic dimensions' as situated within one of five categories or stages: 'the traditional society, the preconditions for economic take-off, the take-off, the drive to maturity, and the age of high mass-consumption' (Rostow, 1960: 2). The traditional society is an essentially agricultural one in which a 'ceiling' exists on the level of attainable output per head – a ceiling determined by 'pre-Newtonian science and technology'. Societies evincing the preconditions of economic take-off are marked by the appearance of new production functions in both agriculture and industry in a dynamic context of expanding world markets and increasing international competition. A decisive feature of this transitional stage is the

appearance of an effective centralized national state, which is 'almost universally' a necessary condition for take-off. The third stage, that of 'take-off', witnesses the unleashing of 'the forces making for economic progress' and their rise to societal dominance. The drive to maturity, a stage lasting some sixty years after take-off, culminates in an economy that evinces the technological and entrepreneurial skills to produce anything that it chooses to produce. Finally, the age of high consumption is characterized by a shift in the leading sectors of the economy towards durable consumer goods and services; as society moves beyond a mere 'technical maturity', it attains the political maturity to allocate increasing resources to social welfare and security, permitting a 'welfare state' to emerge.

The most serious criticisms of modernization theories have concerned their abstract, ahistorical and one-sided character. A one-sided concern with the 'endogenous' factors impeding or promoting modernization and DEVELOPMENT in particular 'undeveloped' societies betrays an unwillingness to explore those 'exogenous' forces operating within the global capitalist system that serve to promote UNEQUAL DEVELOPMENT and thwart dynamic growth in much of the Third World. In assuming that contemporary underdeveloped societies should emulate the 'prescriptions' implicit in the Western 'model' of development and growth, modernization theories characteristically overlook the role of colonial pillage, territorial conquest and the slave trade in effecting the PRIMITIVE ACCUMULATION of capital that was so important a condition of industrial capitalist 'take-off' in Europe and the United States. In suggesting that the salvation of poor countries lies in opening themselves up to Western technology, culture and capital, the theorists of modernization 'forget' that a policy of 'free trade' and 'open markets' was hardly an essential ingredient for the development of any of the first-born nations of capitalist civilization. Neo-Marxist dependency and world-systems theorists (see DEPENDENCY THEORY; WORLD-SYSTEMS THEORY) are particularly vehement in their rejection

of the modernization paradigm. Far from promoting genuine progress in the 'periphery' of world capitalism, they argue, the nostrums of modernization theory are mere recipes for perpetuating the cycle of dependency and exploitation that sustains a persistent structure of global inequality.

The theme of modernization in Marxist theory

Within the Marxist tradition, the theme of modernization has been an understated and controversial one. Marx's 'stages in the economic formation of society' are conceived in terms of a sequence of class-antagonistic modes of production: Asiatic, ancient, feudal and capitalist. The communist mode of production of the future would represent a qualitative rupture with this human 'pre-history', combining the egalitarian social relations of 'primitive communism' with the advanced productive capacities brought into being by capitalism.

In the *Grundrisse* (1973 [1857 8]), Marx writes of an historic transition from 'personal ties' to 'objective bonds' and comes close to counterposing a pre-capitalist traditionalism to a capitalist modernism. But while other social theorists focused on the transition from a rural, agricultural, traditional society to an urban, industrial and modern one, Marx chose to concentrate his analysis on the transformed social relations of production involved in the transition from feudalism to capitalism. Capitalist society is characterized by a contradictory ensemble of exploitative, competitive and formally egalitarian social relations, the effect of which is to reconcile the appropriative rationality central to class exploitation with the technical-instrumental rationality central to the growth of productivity. The resulting capitalist mode of production was the most dynamic and productive in human history, creating more wealth in just a few generations than had been produced by all previous modes of production. In *The Communist Manifesto* (1998 [1848]), Marx and Engels predict that this mode of production will soon batter down

'all Chinese walls', uproot and vanquish all pre-capitalist forms, and create a world after its own image.

This early prognostication of capitalism's universal modernizing mission is at least partially abandoned by Marx in his later economic writings, in particular in the third volume of *Capital* (1981 [1894]). Anticipating later Marxist theories of IMPERIALISM, Marx writes of how 'the internal contradiction [of the capitalist mode of production] seeks resolution through an extension of the external field of production', and of how the tendency of the average rate of profit to fall in developed capitalist countries must be countered by 'foreign trade' and investment (see FALLING RATE OF PROFIT (FRP)). The contradictions and crisis tendencies of a mature capitalism increasingly interfere with its mission to revolutionize the relations of production on a world scale. The advanced capitalist countries look to the cheap raw materials and labour of the colonial and semi-colonial world as a means of shoring up their profits; at the same time, competition for world markets becomes so intense that every established capitalist power has an interest in blocking the emergence of new rivals and keeping the undeveloped countries in a state of DEPENDENCE. These themes are further elaborated, albeit in diverse ways, in the theories of imperialism developed by ROSA LUXEMBURG and V.I. LENIN.

The international communist movement under the leadership of Joseph Stalin and his successors revived the notion that the immediate historical task confronting peripheral capitalist nations was a national-democratic revolution that would extricate pre-capitalist forms and lay the basis for a dynamic capitalist development. Only after a protracted period of capitalist development would the conditions be ripe for a socialist revolution. However, such a strategic conception was difficult to reconcile with a continuing formal allegiance to Lenin's theory of imperialism, which insisted that capitalism was no longer capable of playing a progressive 'modernizing' role on a world scale. More recently, BILL WARREN has sought to

resolve the implicit contradiction by redefining imperialism as the 'pioneer' of capitalism rather than as its 'final stage' and by arguing that capitalist modernization remains a real option for the countries of the Third World.

At the opposite end of the Marxist spectrum, Leon Trotsky and his followers have argued that the laws of combined and uneven development in the epoch of imperialism dictate the need for a strategic perspective of PERMANENT REVOLUTION in the more backward countries of world capitalism. According to Trotsky (see TROTSKYISM), the only way that pre-capitalist forms can be definitively extricated and that such modernizing tasks of the democratic revolution as land reform can be carried out in the countries dominated by imperialism is through a revolution that places the working class (see CLASS, WORKING) in power and creates a planned, socialized economy. The immediate task of such a workers' state would be to use 'socialist methods' to address the 'pre-socialist problems' of industrialization, democratization and general modernization.

See also:

free trade imperialism; historical materialism; interdependence, asymmetrical

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MURRAY E.G. SMITH

monetarism

'Monetarism' is the belief that the money supply is the most important factor determining economic activity. For monetarists, the primary tool of policy-making is the targeting of the rate of growth in the quantity of money. Although monetarist-type ideas had been advocated as early as the 1930s and were taken

up by a cadre of academics in the 1960s, they only became politically relevant after the oil crisis and STAGFLATION of the early 1970s. It was then that policy-makers, in an attempt to make sense of a turbulent economic environment and the perceived failures of KEYNESIAN ECONOMICS, turned to a modified form of monetarism. While the theory and practice of monetarism have been subject to much criticism and debate, certain of its general precepts continue to inform monetary policy in many countries (see MONETARY POLICIES). In particular, its indirect legacies include the notion that macro-economic policy-making should be removed from political control and that price stability should be the first priority of government policy, before employment and growth.

The monetarist emphasis on the quantity of money as the major influence on economic activity has its roots in classical economics, but rose to contemporary prominence due largely to the work of MILTON FRIEDMAN. The chief implication of Friedman's theoretical and empirical studies was that strict control of the money supply is the best way for governments to create the conditions for stable, low inflationary economic growth and thus employment. INFLATION results from the overexpansion of the money supply and can be avoided only if governments are willing to give up trying to manage aggregate demand with counter-cyclical fiscal and monetary manipulations. Setting goals, or targets, for a stable, predictable annual increase in the aggregate money supply, monetarists argued, is the best way to avoid inflation and provide an environment conducive to economic growth. In this view, rules for monetary growth are superior to discretionary policy-making, which is likely to be incorrectly timed or politically manipulated.

Friedman's ideas were taken up most enthusiastically by the British and US central banks under the governments of Margaret Thatcher and Ronald Reagan in the early 1980s, but modified forms of monetarism came into practice across many central banks in Europe and elsewhere. Monetarist principles took on political currency in the late 1970s,

primarily because monetarism could provide an answer to one of the key elements of the MACRO-ECONOMIC POLICY dilemma facing policy-makers: the incompatibility of the Phillips Curve, which had guided government policy-makers throughout the 1960s and early 1970s, with a changed economic environment. In 1958, A.W. Phillips had shown that there was a strong historical relationship between the unemployment rate and the inflation rate. Over almost a century, as inflation rose, unemployment fell, and vice-versa. Thus, post-war policy-makers generally acted on the belief that expansionary monetary policies, while causing some inflation, would also decrease unemployment. This relationship held throughout the 1960s for most industrialized countries but, in the 1970s, governments for the first time confronted conditions that contradicted the Phillips Curve relationship. Inflation and unemployment seemed to move together: high rates of inflation were matched by high rates of unemployment and slow growth, producing the stagflation experience of the 1970s.

The monetarists offered an interpretation for the deteriorating relationship between unemployment and inflation: the Phillips Curve did not exist. Friedman argued instead that each economy has a natural 'non-accelerating inflation rate of unemployment' (NAIRU), independent of the rate of inflation and impossible to change through the use of monetary policy. Thus, there is no permanent trade-off between unemployment and inflation, but neither does price stability lead to higher unemployment.

This viewpoint was strengthened by the work of the RATIONAL EXPECTATIONS theorists, who argued that workers and employers, when faced with increasing levels of inflation in the late 1960s and early 1970s, began to expect inflation and calculate it into their decisions about wages and prices. The result was that people no longer viewed expansionary monetary policy as a boost to the economy, but rather a harbinger of higher inflation. They began to focus on the real value of their wages and demand increases in nominal wages to match the new level of anticipated inflation.

When economic actors are rational in using information to guide their behaviour, policy-makers should adopt a credible anti-inflationary policy to dampen inflationary expectations. A further implication is that the level of unemployment can only be attacked with policies directed at the supply side of the economy, which seek to eliminate the structural barriers to employment growth, such as heavy taxes, inflexible hiring, firing and work rules, and so on. Despite the logical strength of these arguments, many of their associated tenets (such as the notion of a NAIRU) have been impossible to verify empirically.

Monetarist policy experiments were the most pronounced in the United Kingdom and the United States in the late 1970s and early 1980s, although in both cases policies deviated substantially from the strict theory of monetarism. In the case of the United Kingdom, the Labour government began restricting the growth of the money supply in an effort to reassure the INTERNATIONAL MONETARY FUND (IMF) and financial markets shortly before the Conservatives took power in 1979. However, it was a series of policy initiatives by Thatcher's Chancellor of the Exchequer, Sir Geoffrey Howe, and Nigel Lawson (Financial Secretary of the Treasury and, later, Chancellor) that launched the explicit UK monetarist project. Monetary growth targets were set in the Medium-Term Financial Strategy of the 1980 budget; fiscal policy was made consistent with monetary policy; Keynesian style demand-management was abandoned: the ratio of public debt to GROSS DOMESTIC PRODUCT (GDP) was reduced to curtail inflation, and interest rates were no longer manipulated in defence of the pound sterling, but rather were used primarily to control the growth of the money supply.

Yet, in practice, the relationship between money-supply growth and inflation remained elusive, and controlling the growth of the money supply proved difficult. Over- or under-shooting the target rate seemed to have negative effects on the UK economy, while the macro-economic contraction worsened unemployment. As a result, targeting was set

aside in 1985 by the Thatcher government in favour of a more pragmatic approach which allowed for a moderate fiscal expansion and more eclectic approach to controlling inflation.

Similarly, the United States moved to targeting of the money supply in the late 1970s, then aimed for zero or negative growth in 1980 (under Federal Reserve Chairman Paul Volcker) in an effort to combat persistent inflation. While monetary growth did decrease sharply, as did inflation, credit deregulation in the early 1980s complicated the achievement of monetary targets and jeopardized monetary stability. In addition, fiscal policy was never brought in line with the monetarist agenda and massive government spending during the first Reagan administration combined with a restricted money supply to fuel international investment in the US dollar. A rising US dollar brought pressures from exporters for an easing of the money supply which, added to the difficulties with targeting, eventually moved the Federal Reserve (see FEDERAL RESERVE SYSTEM) to a more traditional and varied approach to monetary policy starting in 1983.

An alternative version of the monetarist approach, one which embraced fixed exchange rates, also became part of the policy arsenal of many EUROPEAN UNION (EU) governments in the late 1970s in an effort to combat the effects of stagflation. This 'pragmatic monetarism' was promoted by experts in international organizations such as the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), in policy reports written for the European Community (EC), and in economic policy circles inside the national governments. It was an important part of the necessary conditions for the success of the EUROPEAN MONETARY SYSTEM (EMS) and the progress towards ECONOMIC AND MONETARY UNION (EMU), although it has also been criticized by some as producing slow growth and unemployment in Europe.

While central banks no longer see targeting as a panacea, an overall emphasis on monetary stability continues to drive policy across most of the developed world and much of the developing world as well. The political critique

is muted, but some economists and political activists do publicly lament what they see as an attitude of complacency and lack of political accountability for rising unemployment, arguing for a move away from the monetarist-informed view that unemployment cannot be cured by expansionary monetary policies without unacceptable risk of inflation.

See also:

fiscal policy; money illusion; unemployment, natural rate of

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KATHLEEN R. McNAMARA

monetary policies

The expression 'monetary policies' refers to all the practices adopted by monetary authorities (namely the central banks and treasuries) to change the macro-economic performance of an economy by intervening in the financial markets.

The instruments and methods used in the context of monetary policy change according to the problems. As far as the objectives of monetary policy are concerned, monetary policies may be geared towards both price-stability goals and growth-and-employment ones, depending on the necessities of the economy, as well as the political choices of the monetary authorities. In the first case, monetary policies are defined as 'anti-inflationary' measures, while in the second case they are considered 'expansionary' tools. In neither case, however, are monetary policies alone enough to achieve the desired macro-economic goal.

Regarding the instruments of monetary policy, economists tend to group the techniques commonly used to control the stock of money in circulation in the economy under three headings. The first is direct controls, particularly reserve requirements; the second is control of the monetary base, and the third is interest-rate control. One further thing to consider is the use by the central bank or treasury of 'moral suasion' to convince the banking sector to adopt certain restrictive or expansionary measures.

Direct controls on the money supply operate through authoritative impositions by the monetary institutions on the credit activity of the banking sector. The most-used tools are represented by the adoption of compulsory reserve requirements, which consist of the imposition on the banking system of compulsory deposits to be held in special accounts at the central bank. When the percentage of the banks' assets that must be locked in special deposits with the central bank increases, the supply of credit to the economy decreases in an over-proportional way, reducing the amount of

credit available for the economy as a whole and thus also relieving the economy from inflationary pressures. The reverse is true when the ratio of 'special deposits' is reduced.

Another way to implement monetary policies is to use monetary-base control techniques. Monetary-base control is effected through the imposition of quantitative restrictions on banks' balance sheets that operate via market mechanisms. This technique is based on the conceptualization of the bank as a liquidity-production firm. In this context, control of money supply is achieved by control of the growth of base-money, provided that banks adhere to a stable cash-reserve ratio. Monetary authorities can, by restricting the amount of base money supplied to the banking system through market mechanisms, reduce the amount of cash available to the banks and thus influence the growth of all other monetary aggregates, as well as modify interest-rate patterns.

Finally, monetary policies may be implemented by means of direct interest-rate control. Given the inverse relation between the level of INTEREST RATES and the quantity of money in circulation, an increase in the level of interest rates corresponds to the adoption of restrictive monetary policies, while an easing of the interest rates is identified with the implementation of expansionary monetary policies. In turn, monetary authorities can influence the level of interest rates both by changing the official discount rate and by acting directly in the markets through open-market operations such as the buying or selling of government bonds.

L.S. TALANI

money

Although it is one of the most important objects of study in INTERNATIONAL POLITICAL ECONOMY (IPE), 'money' is also one of the most difficult to define. Economists usually define money according to the functions it performs. Three are usually cited as the most

important: (1) a medium of exchange, (2) a store of value, and (3) a unit of account.

Scholars from other disciplines, however, have found this approach to defining money somewhat limiting. They highlight the fact that money's functions have varied enormously across different historical periods and societies. While modern forms of money usually perform all three of these roles, for example, forms of money in the past have often assumed only one of these functions. Furthermore, money's functions are often not just economic but also political, social and cultural. From a political perspective, money is often most significant as an instrument of power. Sociologists and anthropologists also highlight how money's principal function can be facilitating various social relationships or transmitting cultural values.

Rather than define money solely according to what it does, then, a second approach more acceptable for interdisciplinary work has been to define money also according to what it is and has been in concrete historical settings; what the historian Richard von Glahn calls a 'typological' definition instead of a 'functional' one (Glahn, 1996). Here, one can identify three important types of money that have been used in human societies historically. The most common has been 'commodity money', an object whose monetary value is similar to the value of the material from which it is made. Various commodities have been used as money in this way, but most frequently employed have been those with characteristics such as portability, indestructibility, homogeneity and divisibility (for example, cowry shells or precious metals like silver and gold). Before the nineteenth century, commodity monies were key elements in the monetary systems of most societies around the world.

'Nominal money' is a second type of money that has been used in human societies. It is an abstract money of account indicating a value which has no correspondence to a physical currency in circulation. This type of money performs only one of three economic functions cited above: a unit of account. Its use has often become extensive in contexts where the value of

other forms of money is changing rapidly and unpredictably, or where other forms of money are not homogeneous and standardized. Many monetary systems that were based on commodity monies around the world before the nineteenth century fit these criteria, and thus nominal monies often played a more pervasive role in monetary systems in the past than today.

'Token money' has been the third key type of money used in human societies. This type of money is accepted to have a certain value that is unrelated to the value of the material from which it is made. It is sometimes said to be quite a modern invention, but token money was also common in pre-modern monetary systems in the form of various kinds of paper notes, 'book money' and low-denomination coins made out of base metals, such as copper or brass. During the nineteenth and twentieth centuries, the use of token money did dramatically expand in all countries, as coins took on a 'token' form, and as paper notes and various forms of 'book money' (especially bank deposits) assumed a central place in monetary systems. Today, various token forms of money have come to dominate monetary systems around the world.

International political economists have a special interest in the kinds of money which have been used at the global level. During the emergence of an integrated global economy between the fifteenth and eighteenth centuries, long-distance commerce was facilitated by the commodity monies mentioned above: cowries, gold and (especially) silver. Gold and silver coins issued by leading economic powers (such as Venice, Spain, Amsterdam and England) played a particularly important role as currencies that were accepted around the world. Equally important, however, were sophisticated forms of paper money, as well as various kinds of 'book money' with global reach (for example, account books held at great trading fairs or deposit money held at the Bank of Amsterdam).

In the nineteenth century, two important changes took place in the kind of money used at the global level. First, Britain's dominance of

the world economy ensured that sterling came to be used as the dominant world currency of that age. It was a less 'cosmopolitan' and more 'international' money than world currencies had been in the past. World currencies such as the ducat or the Spanish dollar had been used not only between countries but also extensively within foreign countries alongside domestically issued money. In the nineteenth century, however, this cosmopolitan feature of world currencies diminished somewhat as modern nation-states began to consolidate national currencies that were more territorially homogeneous and exclusive of foreign currencies than domestic monetary systems of the past. The second key change in the nineteenth century was the growing use of the GOLD STANDARD, on which the British monetary system was also based, as the foundation for the monetary systems of the leading economic powers of the world.

In the twentieth century, the dollar gradually replaced sterling as the world's dominant currency, a process that began after World War I and then accelerated rapidly after 1945. From the late 1950s onwards, the dollar also assumed an increasingly 'cosmopolitan' character as it began to be used in a widespread manner, not just between countries but also within foreign monetary systems, with the growth of EURODOLLAR activity in leading foreign financial centres and the 'dollarization' of many monetary systems in DEVELOPING COUNTRIES and ex-Eastern bloc countries after the early 1970s. A further key change in the twentieth century was the erosion of gold's important place as a dominant form of world money, especially after the collapse of the GOLD EXCHANGE STANDARD in the early 1970s. Since this time, money used at the global level has become primarily token or nominal kinds of money. Included in these monies has been one final monetary innovation at the global level in the twentieth century: the creation of new token and nominal forms of money by supranational authorities, such as the SPECIAL DRAWING RIGHTS (SDRs) created by the INTERNATIONAL MONETARY FUND (IMF), the EUROPEAN CURRENCY UNIT (ECU) of

the EUROPEAN COMMUNITY (EC) and the euro of the European Monetary Union (EMU).

See also:

dollar, US

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ERIC HELLEINER

money illusion

The 'money illusion' refers to a tendency for people to take insufficient account of inflation when assessing changes in prices or wages. For

example, an increase in money wages may be interpreted as a real gain, whereas prices may be rising at such a rate as to totally offset the benefits. In this case, the workforce may be misled into offering more labour. The illusion could also affect spending behaviour (for example, if people erroneously believe they are better off). Opinions vary on the prevalence of the money illusion in practice – the RATIONAL EXPECTATIONS school, for example, reject it completely.

JOHN CLARK

money markets

‘Money markets’ are markets for high-quality short-term debt with maturities of a year or shorter. The market is wholesale: banks, corporations and governments trade very large quantities (for example, US\$100 million) in a single transaction. The US money markets are the largest. Key instruments include Fed funds (deposits held at the US Federal Reserve – see FEDERAL RESERVE SYSTEM), Treasury bills (US government debt with a maturity of one year), Certificates of Deposit, COMMERCIAL PAPER, repurchase agreements (securities are temporarily exchanged for a loan) and bankers’ acceptances (a bank’s guarantee that a purchaser of goods not yet received will pay). Sizeable money markets exist in countries other than the United States, most notably Canada, France, Germany, Japan and the United Kingdom.

DEREGULATION has encouraged the growth of money markets: for instance, it was only from 1986 that French treasury bills could be held by all investors – previously, in most cases, only financial firms were allowed to hold them. Money markets have become increasingly globalized with the growth of the EURO CURRENCY MARKETS and the EUROMARKETS more generally. For example, a large market in eurocommercial paper (short-term notes issued by firms denominated in foreign currency) developed during the 1980s. The growth of the FOREIGN EXCHANGE markets is also a sign

of (and has further contributed to) the globalization of money markets, as market participants find it increasingly easy and cost-effective to move across national money markets in search of the best deal.

Governments use the money markets to influence the money supply and interest rates: by buying and selling government securities, they can release cash into the system or extract cash from it.

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TONY PORTER

money-centre banks

‘Money-centre banks’, also known as ‘money-market banks’, are large commercial banks located in the major financial centres such as Chicago, London, Los Angeles, New York and Tokyo. In contrast to their smaller regional counterparts, whose business is more locally based, money-centre banks play a large role at the national and international level. They act as lenders to governments and corporations, as well as offering depository, master trust and FOREIGN EXCHANGE services to the regional and community banks. Money-centre banks are also large purchasers of securities and money-market instruments.

See also:

financial institutions; money markets

ADAM HARMES

monopolies

The term ‘monopoly’ is used in different ways depending on the theoretical perspective or PARADIGM. Marxist and radical writers often

use this term when referring to big business, particularly for industries dominated by a small number of firms that have not only MARKET POWER, but also social and political influence. This usage contrasts with that of mainstream economists, by whom the term OLIGOPOLY would normally be used – they would limit the term monopoly to when there is only one supplier of a product. However, the difference goes well beyond mere terminology to involve the analysis and appraisal of capitalist economies and their historical evolution. Despite the differences, though, it would be agreed that the size of the biggest firms measured by sales, output or profits, has grown enormously in the twentieth century. There are many industries where a small number of firms dominate, not just in particular countries, but increasingly on a worldwide basis (for example, some types of aircraft, computers and satellite television – all industries that did not exist at the beginning of the twentieth century). In addition, since 1980 there has been a rapid growth in the number of strategic alliances between large (and also medium-sized) firms, many of them international in scope. Such developments have led to fears that the concentration of ECONOMIC POWER is becoming excessive and to suggestions that tighter regulation – national and international – is needed.

Some radical writers go so far as to argue that effective democracy is being undermined by the rise of transnational corporations (TNCs) and even a transnational capitalist class (see MULTINATIONAL CORPORATIONS (MNCs); TRANSNATIONAL CAPITALIST CLASS (TCC)). At the same time, mainstream economists are sceptical as to whether, on average, industrial concentration (that is, the degree of domination of an industry by the largest firms) has risen since 1960, stressing the rise of many East Asian firms and the break-up of state-owned monopolies in the 1990s, linked to a surge in the PRIVATIZATION of state enterprises and the collapse of COMMUNISM. In computers, INTERNATIONAL BUSINESS MACHINES (IBM) suffered relative decline in the 1980s, while the dominance of the big oil majors (known as the 'seven sisters' because of their collaboration from the 1930s to the 1970s)

declined in the second half of the twentieth century. Thus it is possible that capitalism is becoming simultaneously more transnational and more competitive in the age of the information technology revolution, rapid communications, cheaper transport and freer trade. In international political economy (IPE), these rival interpretations are linked to debates about the role and influence of states in an age of CAPITAL MOBILITY, TRANSNATIONALLY INTEGRATED PRODUCTION and, more generally, GLOBALIZATION.

Within mainstream/neo-classical economics, the single monopoly firm is seen as having great market power over buyers who have no choice short of refusing to buy at all, or perhaps to buy a very imperfect substitute from a different industry. This is seen as a recipe for high prices, poor quality and little incentive to innovate – all major failings of PLANNED ECONOMIES under communism where, in effect, state monopolies prevailed in all or most industries. Countries, like India, with a large state-owned sector and high trade barriers, have experienced similar (if less extreme) failings. Neo-classical economists argue that the collapse of communism and the worldwide surge in privatization partly reflects the superior economic performance of capitalist countries, including the East Asian ones. However, neo-classical economics implies that this performance could have been even better if stronger policies to promote competition and a flexible labour market had been adopted – for example, anti-competitive practices should be punished. Such are the kind of neo-liberal views promoted by the WORLD BANK, especially in the context of structural adjustment (see STRUCTURAL ADJUSTMENT PROGRAMMES (SAPs)). One argument for the Single European Market (SEM) was that competition would be increased by breaking down national regulatory barriers to foreign firms, opening up public procurement to more rival bids and ending state monopolies in sectors like energy and telecommunications. More generally, where oligopoly or even pure monopoly prevail within a national market, then freer trade would enhance competition – and also job

insecurity. From this perspective, if TNCs are among the main winners in a more open and competitive (Darwinian!) world economy, then it is because they are more efficient – to the benefit of consumers who have purchasing power. Here a radical political economist would suggest that such purchasing power was becoming more unequal as the balance of power shifts in favour of big business and against all but the most skilled types of labour.

Marxian economics/political economy takes a much more critical and, in some ways, less optimistic stance, partly because it sees the state itself as severely constrained (or even captured) by a combination of capital markets, big business and, more generally, the capitalist class and its favoured ideas. ECONOMIES OF SCALE and scope give an advantage to big firms and large plants, ensuring the dominance of monopolies (in the broader, Marxist sense) in most key sectors of the economy. Big firms, as well as seeking profits, are very interested in reducing risks. Hence it is logical for them to pursue inter-firm alliances, cartels and other anti-competitive practices (see ALLIANCES, INTER-FIRM; CARTELS); to use ADVERTISING to shape consumer tastes and raise entry barriers to potential new firms; to use product innovations to create the basis for MONOPOLISTIC COMPETITION or even outright monopoly (even by shaping the technical standards in an industry), and lobbying and political networking so as to shape state policies. It is worth stressing that, within the broad category of an industry, there are often many products, and PRODUCT DIFFERENTIATION is a feature of both consumer durables and machinery. An apparently modest level of concentration in output shares in an industry can mask high levels of market power in certain segments of the market. In response to this point, a neo-classical economist might suggest that big firms from within or even occasionally outside the industry could invade such segments or niches if they perceive profits to be exceptionally high. This possibility serves to inhibit abuses of monopoly power by the niche monopolist that knows its market position is contestable. Given the diversified and diversifying character of

many big firms, this point has some validity. Furthermore, while product innovation can confer monopoly profits, the pace of innovation is now so fast in many industries that such advantages are short-lived because, for example, product cycles have shortened since 1945.

Viewed from a radical perspective (ironically a perspective sometimes echoed in management studies), firms are engaged in varied power games that go well beyond competitive efforts to please the supposedly sovereign consumer. A crucial aspect of building power concerns labour relations, where big businesses (especially TNCs) have sought to improve their bargaining position relative to that of unions, with considerable success in the 1980s and 1990s. Sometimes this can involve investing in regions with high unemployment and in relatively small towns where they become the main employer; with a monopolistic position in the supply of local jobs, the company's bargaining power is entrenched.

A characteristic feature of Marxist analysis is an attempt to distinguish different stages of capitalism. LENIN and others suggested early in the twentieth century that a new MONOPOLY CAPITALISM had emerged and was a primary cause of IMPERIALISM. Some writers in the 1980s have gone a stage further and suggested that we are in a new phase of transnational monopoly capitalism. Others have analysed the possibility that a transnational capitalist class is emerging, in which there are close links between international organizations (such as the INTERNATIONAL MONETARY FUND (IMF) and WORLD BANK) and transnational corporations/monopolies.

The reaction of states to monopolies has varied over time and between countries, and explaining this variation is a challenge to political economists. In the United States, there has been a traditional suspicion of monopolies, a suspicion reinforced by scandals like the attempt of Bunker Hunt to corner the silver market – this particular villain is thought to have been echoed in the *Dallas* television series, popular in the later 1970s and 1980s. (On the record of the United Kingdom, see COMPETITION COMMISSION (CC).)

monopolistic competition

See also:

monopoly

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DAVID LAW

MONOPOLIES AND MERGERS COMMISSION (MMC) see Competition Commission (CC)

monopolistic competition

'Monopolistic competition' refers to a type of competition between firms (or industries or even countries) which combines elements of both MONOPOLY and PERFECT COMPETITION. In its simplest form, as in perfect competition, a monopolistically competitive market contains a competing group of single-product firms with identical cost and demand functions (a uniformity assumption). However, as in monopoly, each firm faces a downward-sloping demand curve because their products are different. There is horizontal PRODUCT DIFFERENTIATION as in, for example, the market for restaurant meals in a particular town: different style restaurants compete for customers while having some limited ability to price independently.

The entry of an $(n + 1)$ th firm into such a market leads to the flattening of the individual firms' demand curves, as the market shares of the n pre-existing firms fall from $1/n$ to $1/(n + 1)$ (a symmetry assumption). PROFIT MAXIMIZATION by firms leads to prices above marginal cost and to average costs not being minimized (price and cost inefficiency). This inefficiency represents the cost of additional consumer

choice. Other models of product differentiation relax the restrictive key assumptions.

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MICHAEL G. POLLITT

monopoly

A monopoly exists when there is only one supplier of a good or factor of production; hence, there is no competition, so the supplier can charge a higher price and/or impose lower quality than normal – unless regulated by the state. However, the state may favour monopoly POWER in certain industries for reasons of revenue or national security.

See also:

deregulation; liberalization; monopolies; monopolistic competition

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DAVID LAW

monopoly capitalism

'Monopoly capitalism' is a concept, developed by dissident and Marxist political economists, that describes the mature phase of capitalism, in which it is ruled by giant firms and governed by distinct laws of motion in contrast to earlier 'competitive' capitalism.

The theoretical cue comes from KARL MARX, who argued that normal competition produced the 'concentration and centralization' of units of capital accumulation, but the

first systematic attempts to theorize MONOPOLY as a distinct system were made in the early years of the twentieth century by the American institutionalist economist THORSTEIN VEBLEN and the Marxist RUDOLF HILFERDING. Mainstream economics did not take up Veblen's ideas, but after Hilferding it became a staple of Marxism that capitalism had, from the late nineteenth century, entered a new phase, dominated by big firms.

Hilferding described the concentration of capital through the rise of large joint stock enterprises, and the formation of CARTELS and combinations. The MARKET POWER of these methods permits greater profits and encourages emulation – generalizing monopoly and cartelization throughout the economy. Financial interests come to dominate industrial capital through their strategic role as a conduit of the investment funds required for large-scale operations. Huge fixed capital investments and monopolized markets obstruct the mobility of capital and the equalization of profit rates across the economy. Hilferding tried to integrate his ideas with Marxist value theory, but was forced to conclude that price formation tended to become arbitrary and unstable – governed by the power and decisions of individual monopoly units, rather than by laws operating through the blind collision of a multiplicity of units in the market.

Despite the wide currency of the term, the likely economic and political consequences of monopoly were disputed. Some expected an attenuation of domestic economic crises and saw in monopoly an anticipation of the 'socialization' of economic ownership. It thus provided some on the Left with 'reformist' conclusions – they argued that all that was required was a socialist electoral victory to consummate the process of capitalism's self-supercession. (A case echoed during the post-World War II boom by social democrats, like John Strachey and Anthony Crossland in Britain, who said the 'separation of ownership and control' of industry displaced the anarchic pursuit of short-term private profit with long-term planning for growth: that is, capitalism became socially responsible.)

The second focus of disagreement was international politics. The Marxist KARL KAUTSKY thought the principle of cartelization would extend from economics to international relations, establishing peaceful cooperation between leading industrial powers (see ULTRA-IMPERIALISM). Against this, Marxist critics like LENIN and BUKHARIN expected monopoly to promote an expansionist alliance between giant concerns and individual national states – producing imperialist war between the major powers (see IMPERIALISM).

After the Stalinization of official communism in the 1930s, official Eastern bloc theory of Western capitalism 'rigidified' around the idea of an alliance between big capital and the state – described as 'state monopoly capitalism'. In the West, academics and economic writers noted the development of large firms and monopoly, while during the inter-war crisis many connected monopoly with economic stagnation, but mainstream theory was poorly equipped to deal with either. The concept of monopoly capitalism as a distinct system arose in the space between official communism and Left Keynesianism (see KEYNESIAN ECONOMICS), in the work of dissident economists and eclectic revisers of Marx.

The first of these, Michael Kalecki, thought capitalism to be as crisis-prone as Marx did, but for different reasons – tied up with monopoly. The mark-up of firms' prices over costs was determined by the 'degree of monopoly' – the level of concentration or cooperation between firms and the strength of their marketing. Fusing this interest with Keynesian themes (which he independently anticipated), Kalecki argued for a link between the IMPERFECT COMPETITION of monopoly and macro-economic demand failure. This underconsumptionist theme (see UNDERCONSUMPTION) became central to the concept of monopoly capital in the work of his student, Josef Steindl, and the neo-Marxists PAUL BARAN and Paul Sweezy – whose book *Monopoly Capital* (1966) became the most famous exposition of the concept. All argued that monopoly redistributed shares in national income towards profits relative to wages, and linked it to a long-term

tendency to stagnation, due partly to the consequent weakening of demand. All four writers continued to stress stagnationary tendencies after World War II, when Keynesians lost interest because the boom seemed to show they had been outgrown.

Baran and Sweezy's *Monopoly Capital* offered a general sociological critique (inflected by the Frankfurt School) of mature capitalist society, that connected with the political radicalism of the 1960s, becoming the cornerstone of the dominant current of US neo-Marxism via the journal *Monthly Review*. Their theory centred on the generation of (and problems of absorbing) the economic surplus in monopoly conditions. Giant firms control production, prices and investment in particular industries, allowing them to curb mutually destructive price-wars, while cost-reduction continues. The monopolies pocket the difference between downwardly rigid prices and falling costs. The macro-economic result is the 'law of the tendency of the surplus to rise' – which replaces Marx's 'law of the tendency of the rate of profit to fall' (see CRISIS THEORY; FALLING RATE OF PROFIT (FRP)). Presuming that consumption rises slower than productive potential, and the validity of the (underconsumptionist) argument that this will tend to produce stagnation (since absorption of the surplus by investment merely recreates the problem on a larger scale), they conclude that monopoly exacerbates this tendency.

In the long run, this has been counteracted by 'external' factors – epoch-making innovations like the railway and the great waves of 'automobilization'. In addition, there are ways in which surplus can be absorbed that temporarily offset this tendency – here Baran and Sweezy attempt to integrate key features of post-war capitalism into their theory. These include rising expenditure by private business on their sales efforts (advertising, product differentiation and so on), consequent on the shift from price competition to marketing, and the massive growth of civilian and military spending by governments.

They assert that, over the long term, none of these has a permanent effect but, in so far as

they temporarily succeed, the potential for challenging monopoly capital at its centre is weakened. So their theory dove-tailed with claims that the real challenge to capitalism had moved to the THIRD WORLD. Moreover, Baran helped lay the foundations of post-war theories of UNDERDEVELOPMENT and dependency, some of which are predicated on monopoly capital theory.

Also predicated on this are theories of US imperialism developed by Magdof and O'Connor within the *Monthly Review*, current from the 1960s onwards. Developing the themes of (respectively) competing monopolies and the problems of surplus absorption as the causes of expansionism, these two also stressed the *de facto* dominance of the US state and US capital over potential rivals, with O'Connor arguing as far back as the 1970s that a united international ruling class had been forged under US leadership. Viewing the United States as the policeman of a world corporate ruling class is now probably more popular than ever on the Left, after the collapse of the Eastern bloc and the rise of US-led intervention.

A rather different use of the concept of monopoly capital in the analysis of contemporary transnational capitalism can be found in the work of Keith Cowling and his associates. Cowling echoes a general theme of monopoly capital theory (that it entails a growth in the collective power of corporate monopolies relative to labour and society generally) and fuses it with a (now widespread) case about globalization, arguing that transnationalization strengthens the power of big firms against governments and labour, putting downward pressure on wages and increasing underconsumptionism. Unlike the dominant neo-liberal version of 'globalization', Cowling continues to stress the monopoly tendencies and power of corporations. Hence, he claims that internationalization has not merely produced greater price-competition (because foreign entrants to domestic markets may emulate, rather than undercut, the prices of established firms) and that price-cutting in foreign markets is more likely if firms have secure monopolistic positions at home.

Of the various theories, Baran and Sweezy's has attracted the greatest critical attention – much of it from 'classical' Marxists. Key objections are: evidence that monopoly attracts greater profit margins is ambiguous, and the fundamental competition (in Marxist terms) between capitals is not in particular product markets, but as purchasers of labour power that none are able to monopolize. More generally, many assert that (despite the rise of giant firms) monopoly remains an unstable condition in any market and one that has not inaugurated a new set of macro-economic laws.

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ANDREW WRIGHT

monopsony

'Monopsony' means there is only one buyer for a product. Given many suppliers, the monopsonist has MARKET POWER -- they pay a lower price than when buyers are numerous. A large

TRADE BLOC of country may gain such market power, usually under OLIGOPSONY.

See also:

duopsony; optimal tariff

DAVID LAW

Monroe Doctrine

President James Monroe issued the Monroe Doctrine in 1823 as a unilateral declaration of intent by the United States to create for itself a sphere of influence in the Western Hemisphere. Reflecting deep isolationist sentiments in the United States, it sought to prevent the reconquest of Latin America by the crowned colonial powers of Europe. The doctrine stated that the United States would: (1) resist further European colonization in the hemisphere; (2) consider as a threat to the peace and security of itself any attempt to extend European systems of government in the Americas, and (3) refrain from meddling in the affairs of European countries.

From the beginning, the United States rarely enforced or strictly adhered to the doctrine. In its first three years, Washington denied or evaded five specific requests to guarantee Latin American independence. Historical records of private discussions of the doctrine within Monroe's cabinet show that the United States never intended to commit troops to defend Latin America. Furthermore, US involvement in European affairs has been extensive since World War I.

The great irony of the Monroe Doctrine is that the United States frequently used it to justify and advance its own regional objectives, cloaking itself in the doctrine while repeatedly intervening in Latin America. President James K. Polk invoked the doctrine in the annexation of Texas, previously part of Mexico, and then took by force large tracts of Mexican territory. President Woodrow Wilson later used force to remove a Mexican president from office. General John J. Pershing led US troops into

Mexico to punish Pancho Villa for a raid in Texas. US troops also invaded Haiti, the Dominican Republic and Nicaragua, where they stayed more than twenty years. All of these actions were taken in the name of the Monroe Doctrine.

This pattern of distortion and misuse continues in the contemporary era. During the Central American turmoil of the 1980s, patriotic appeals to the Monroe Doctrine were made to justify intervening in those countries. Some advocated expanding the doctrine to prohibit 'subversive ideologies' in the hemisphere, permitting the doctrine's broad use against communist movements (see COMMUNISM).

WILLIAM P. AVERY

MONTREAL TERMS see debt crisis

Moore, Barrington (1913–)

From his earliest work on the nature of and prospects for Soviet Russia to his most recent work on injustice and inequality, Barrington Moore's work has been concerned with the problems of the social origins and nature of democracy and dictatorship, obedience and revolt, misery and happiness, and freedom and necessity. Belonging to no particular contemporary school of thought, Moore has insisted that in order to avoid the triviality and empty formalism which threatens to engulf much modern social science, its practitioners ought to follow the tradition of the enlightenment (in its sense of moral purpose and search for a rational social order) and the example of the nineteenth-century and early twentieth-century social theorists, such as MARX, de Tocqueville, Durkheim and WEBER (who were at once comparative, historical and critical in their approach to social and political inquiry).

Barrington Moore's most well-known work is *Social Origins of Dictatorship and Democracy* (1967). Here Moore engages in a comparative study of the social history of England, France,

America, China, India and Japan, and also (although not at such length) of Germany and Russia. His focus is on the paths taken within these societies in their transition towards industrial modernity. In particular, Moore is concerned with the question of the extent to which the development of the political institutions in each case can be understood in terms of the structure of the relationships between the peasantry and the landed upper classes. Moore argues that there have been three routes from the pre-industrial to the modern world. These are: (1) 'bourgeois revolution', (2) the 'capitalist and reactionary' route and (3) communism.

In England (the key example of 'bourgeois revolution'), the landed upper classes allied themselves with the movement towards democracy and capitalist forms of production. In the second case (exemplified by Germany and Japan), an essentially capitalist route became fascist in the mid-twentieth century. The third route is exemplified by China and Russia. India is included because it does not fit easily into this framework.

Controversially, Moore sought to find an objective morality which would guide conduct in a world where there is still considerable scope for human freedom despite the existence of universal structural constraints.

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PETER LASSMAN

moral hazard

The concept of 'moral hazard' was first applied to the economics of risk insurance, but has come to be seen as a feature of relations between governments, banks, companies (as borrowers) and the INTERNATIONAL MONETARY FUND (IMF) that contributes to problems of GOVERNANCE and REGULATION. When governments openly or implicitly say they will 'bail out' financial institutions facing collapse, there is a temptation for those institutions to lend excessively or carelessly, thereby increasing the risk of unpaid debts, banking crises and slumps. Economists see the problem as one of MARKET FAILURE, rooted in imperfect information and monitoring. It is difficult for governments to know how far and why banks are mismanaging lending risks, and thus to discriminate in favour of 'responsible' banks when giving support. An 'irresponsible' attitude may also apply to firms who borrow from banks, hoping they will be given extra time to repay if necessary. A government may be tempted to run up debts through reckless macro-economic policies (see MACRO-ECONOMIC POLICY) if it thinks it can borrow cheaply from the IMF or WORLD BANK in a crisis (unless deterred by loan CONDITIONALITY). However, even if the government (IMF) had more information on borrowers, it might lack the political will to avoid bail-outs. Are some banks (countries) too big to be allowed to collapse? The informational 'market failure' of moral hazard is often embedded in politico-economic structures and cultures which encourage cronyism. The debt crises of East Asia

in 1997 8 highlighted close and corrupt government-business links leading to calls for not merely better information and transparency but an end to 'crony capitalism'.

See also:

debt crisis; debt problem

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DAVID LAW

Morgenstern, Oskar (1902–77)

Oskar Morgenstern is chiefly remembered as the co-author, with the great mathematician John von Neumann, of *Theory of Games and Economic Behavior* (1944) – a book with revolutionary new applications to economics and the other social sciences.

The two intellectual centres of Morgenstern's life were Vienna and Princeton. Morgenstern studied at the University of Vienna, where he got his doctorate in 1925 and his habilitation in 1928. At the end of 1928, he moved to the Austrian Institute of Research on Business Cycles, where he succeeded FRIEDRICH AUGUST VON HAYEK as the director from 1931 to 1938. During the 1930s, he also was the managing editor of the *Zeitschrift für Nationalökonomie*, then the leading scholarly journal in the German language-area and an international forum for debates on business-cycle theory, capital theory and the role of time in economics. After the Nazis' invasion of Austria in March 1938, Morgenstern (who had been dismissed from his positions in Vienna) accepted an offer from Princeton, where he became a member of the Institute for Advanced Study in 1938 and full Professor of Political Economy from 1944 to 1970. After his

most favoured nation

retirement, he became Distinguished Professor in Game Theory and Mathematical Economics at New York University. He was consultant to the White House, the US Atomic Energy Commission and the Rand Corporation, Chairman of the Board of Mathematica Inc. (1959–77) and co-founder of the Institute for Advanced Studies in Vienna.

Morgenstern's work was more strongly influenced by pure mathematicians and natural scientists – Karl Menger, Kurt Gödel and Albert Einstein were close friends – than by the leading mathematical economists of his time. Emphasizing the difficulties of accounting for foresight and anticipation, for the effects of prediction on the course of events, Morgenstern always remained highly critical of standard neo-classical economic theory, with its emphasis on general equilibrium (see GENERAL EQUILIBRIUM; NEO-CLASSICAL ECONOMICS). People cannot have perfect foresight if that foresight has to include the foresight of actions of other agents who are assumed to have perfect foresight as well. The mathematical structure of social phenomena, therefore, is profoundly different from that of the world of physical nature.

The roots of GAME THEORY can be traced back to his 1928 habilitation thesis on *Wirtschaftsprognose* (economic forecasting) – which was written while Morgenstern was a Rockefeller Foundation Fellow in the United States (1926–7) – and to his 1935 paper on 'Perfect foresight and economic equilibrium'. In these writings, Morgenstern not only emphasized the incompatibility of perfect foresight and economic equilibrium, but was also already discussing the Sherlock Holmes Moriarty case, which can be considered the first example of a two-person zero-sum game with no saddle-point in pure strategies – proving seminal for the later analysis of optimal decision-making.

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HARALD HAGEMANN

most favoured nation

The 'most favoured nation' principle has been central to many of the multilateral trade negotiations during the post-World War II era and has been enshrined through agreements concluded under the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) and its successor the WORLD TRADE ORGANIZATION (WTO). The principle requires signatories to such trade agreements to grant to all their trade partners the most favourable terms that they grant to any other of their trade partners, thereby ruling out discriminatory trade practices.

R.J. BARRY JONES

MOTORIZATION see automobilization and motorization

Multi-Fibre Arrangement (MFA)

World trade in textiles and clothing, totalling just over US\$300 billion in 1996 (equivalent to about 6 per cent of all world trade), is subject to heavy protection. More than three-quarters of it is subject to quotas organized within bilateral agreements, which in turn operate within the framework of what is called the Multi-Fibre Arrangement (MFA). It is worth noting that this arrangement:

- 1 was intended to be temporary when first set up and has in fact lasted for over thirty years;
- 2 is a major departure from the principles of free trade espoused by first the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) and then by the WORLD TRADE ORGANIZATION (WTO);

3 is scheduled to be phased out between 1995 and 2005

Thus, the majority of trade in textiles (and clothing) is restricted, not only by tariffs but also by quotas under the MFA. Restrictions on textile imports into the developed countries (DCs) date back over half a century, when the United Kingdom and the United States used measures to limit the then growing textile exports of Japan. Then, in the 1950s, when a combination of excess capacity in the textile sectors of many of the old industrialized countries coincided with an increase in production in some of the NEWLY INDUSTRIALIZED COUNTRIES (NICs), the United Kingdom and other countries 'negotiated' Voluntary Export Restraints (VERs) with the new suppliers (Japan, Hong Kong and India). In the early 1960s, these bilateral agreements were arranged within a multilateral framework, negotiated under the auspices of the GATT and called the Short-Term Arrangement on Cotton Textiles (STA). The STA *was* short – it lasted one year – but it was replaced by the Long-Term Arrangement Regarding International Trade in Cotton Textiles (LTA). This was referred to as an 'exceptional and transitional measure', originally covering the five years from 1962 to 1967, but was renewed in 1967 and again in 1970. In 1974, the LTA was replaced by the Multi-Fibre Arrangement (MFA): in fact by a succession of MFAs within the GATT. Under these MFAs, the major developed countries (with the European Union counting as one member) have been allowed to put VERs on imports from developing countries under bilateral agreements.

Thus the MFAs were intended to provide protection and a temporary breathing space in order that the importing developed countries might adjust their industries. The exporters have had no choice but to agree to the MFAs for fear of a worse alternative, namely disorderly and unpredictable unilateral action by developed countries under the GATT safeguard clause. Thus the MFAs can be said to have been both *outside* and *inside* the GATT: *outside* in the sense that the MFAs were a

major departure from the anti-discrimination principles of the GATT; *inside* in the sense that the MFAs were designed to regularize this departure from the GATT.

The main effect of the quotas has been two-fold. First, as QUOTAS become fully utilized for particular items of textiles and clothing in the established producing countries, investors have expanded in non-quota countries to tap relatively cheap sources of labour. Second, the quotas have encouraged the quality upgrading of textiles and clothing in those countries reaching their export-quota limits.

By the late 1980s, just over half of the textile and garment products exported by less-developed countries (LDCs) were subject to VERs and the average quota utilization was more than 90 per cent. Thus, just under half of all exports of textiles and garments from LDCs were constrained by quotas. By the late 1990s, this proportion had risen to well over half.

With the completion of the URUGUAY ROUND and the establishment of the WTO, an Agreement on Textiles and Clothing (ATC) came into force in January 1995. Under this agreement, which is supervised by the Textiles Monitoring Body of the WTO, the MFA quotas are due to be abolished in four stages between 1995 and 2005, but with almost half of the products being liberalized by the end of the transitional period (namely the end of December 2004). In a WTO review of the ATC carried out in late 1997, a number of LDCs expressed concern about this 'backloading' and it is reasonable to assume that the majority of the quota restrictions will remain effectively in force until close to the year 2005. It needs also to be noted that most of the world trade in textiles and clothing is potentially subject to new protective restrictions under 'safeguard clauses'.

See also:

free trade

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Multilateral Agreement on Investment (MAI)

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CHRIS EDWARDS

Multilateral Agreement on Investment (MAI)

The Multilateral Agreement on Investment (MAI) began to be negotiated officially among the member-states of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) in 1995, having been given a mandate by the OECD ministerial meeting the previous year. The negotiations continued until October 1998, when the French government announced that it would no longer participate, citing conflicts with national sovereignty and the protection of France's cultural industries. In early 1999, it was unclear what role the OECD would play in any future discussion of such an agreement, but the possibility of negotiating investment issues with the WORLD TRADE ORGANIZATION (WTO) was being discussed.

The proposed MAI was a very far-reaching agreement, which sought to extend certain features of bilateral investment treaties to all the OECD member-countries within a multilateral framework. The treaty would be open to accession by non-OECD countries and aimed to provide 'a benchmark against which potential investors would assess the openness and legal security offered by countries as investment locations'.

A central aspect of the MAI was that signatories should not discriminate against foreign investors compared to nationals (NATIONAL TREATMENT), nor between foreign investors from different countries (MOST-FAVOURED-NATION treatment). Unlike some other investment liberalization schemes, the MAI covered the pre-establishment as well as the post-establishment phase, and used a very broad definition of investment, including intellectual property and portfolio investment as well as FOREIGN DIRECT INVESTMENT (FDI). It gave

investors the right to take governments to an international tribunal in the instance of investment disputes.

When news of these proposals leaked out, anti-MAI campaigns sprang up in a number of countries, involving environment and development non-governmental organizations, consumer organizations, human rights groups, trade unions, local governments, politicians and churches. Critics of the MAI argued that it was being negotiated within an exclusive group of rich countries and that its provisions took no account of the development needs of the majority of the world's countries. It was also seen as a threat to environmental protection and to workers' rights. Its proposals, by focusing exclusively on investor protection and measures to liberalize international investment, were fundamentally unbalanced. It emphasized the rights of companies, with no corresponding obligations on their part. The MAI did not, for instance, address issues of restrictive business practices on the part of firms. The campaigns were successful in raising public awareness of the dangers associated with the MAI and helped derail the OECD negotiations.

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RHYS JENKINS

MULTILATERAL AID *see* aid, multilateral

multilateralism

'Multilateralism' has become increasingly evident in the formal and informal diplomacy among international actors in the twentieth century. It is most visible in activities centred around INTERNATIONAL ORGANIZATIONS (IOs), especially those of the UNITED NATIONS (UN) system. It permeates regional and global

efforts to address economic, social and environmental issues, as well as to control the use of force. Multilateralism has been defined as recurring efforts to coordinate relations between three or more states on the basis of certain generalized principles of conduct, indivisibility and expectations of diffuse RECIPROCITY. It can be contrasted with unilateralism (the actions of one state taken without consultation or coordination with others) and bilateralism (the coordination of actions by two states). It is inextricably linked with efforts to develop international GOVERNANCE, with openness and inclusiveness of different actors, issues and values.

Multilateralism has grown as inter-governmental organizations (IGOs), NON-GOVERNMENTAL ORGANIZATIONS (NGOs), global conferences and international regulatory regimes have proliferated in the twentieth century, affecting the very dynamics of world politics. Some scholars now refer to a post-Westphalian system of world politics in which the interests of sovereign states are only one part of the picture and anarchy no longer aptly describes the character of the emerging system, where networks of IGOs, NGOs and various non-state actors play increasingly important roles and multilateralism is a predominant form of interaction (see ANARCHY, INTERNATIONAL; WESTPHALIA, TREATIES OF).

Multilateralism, then, is associated with formal international organizations with budgets, headquarters and voting procedures, such as the United Nations (UN), the INTERNATIONAL MONETARY FUND (IMF), WORLD TRADE ORGANIZATION (WTO), EUROPEAN UNION (EU) and ASSOCIATION OF SOUTH-EAST ASIAN NATIONS (ASEAN). It is also associated with less structured or formally organized initiatives, such as the GROUP OF 7 (G-7), the ASEAN Regional Forum (ARF) and UN-sponsored global conferences.

What has prompted the twentieth-century growth of multilateralism and what is its significance? What are the advantages and disadvantages of multilateralism? How do scholars explain the variations in multilateralism?

Explaining the growth of multilateralism

Among the major international relations (IR) theories, LIBERALISM has a long history of concern with the importance of international law and organizations for ordering international society, a history that can be traced to the seventeenth-century Dutch publicist HUGO GROTIUS (the 'founder' of international law) and Immanuel Kant (the eighteenth-century philosopher of 'perpetual peace'). Liberals link the rise of multilateralism to growing economic interdependence, the destructiveness of twentieth-century world wars, new technologies (the transport, telecommunications and other revolutions), the expansion of the state system with DECOLONIZATION in the 1960s and the end of the COLD WAR in the 1990s, the emergence of global issues (for example, environmental degradation, AIDS, human rights and development), and the tendency of IGOs to create other IGOs. FUNCTIONALISM and its close relative NEO-FUNCTIONALISM – offshoots of liberalism – have offered powerful explanations of multilateralism, rooted in the expanding needs of an enlarged state system and the SPILL-OVER of success in dealing with selected practical non-political problems to new (and even to sensitive) political issues. European INTEGRATION (beginning with the EUROPEAN COAL AND STEEL COMMUNITY (ECSC) in the 1950s and leading ultimately, today, to the EU) has frequently been the model of this process. The expansion of the UN system and its specialized agencies, as well as regional and other IGOs, also is regarded as the result of functionalism.

Liberal scholars trace the history of multilateralism from key nineteenth-century roots. These include the Concert of Europe established in 1815, the early functional international organizations associated with rising commerce, communications and technological innovation – such as the INTERNATIONAL TELEGRAPH UNION (ITU) (1865), UNIVERSAL POSTAL UNION (UPU) (1874) and the Office International d'Hygiene Publique (1907) – and the two Hague Conferences convened in 1899 and 1907 to develop mechanisms for peaceful

settlement of conflicts and arms limitation. Each of these set important precedents for the practice of multilateral diplomacy.

More recent scholarly work on multilateralism has built on theories developed in the 1980s about international cooperation and coordination, regimes, institutions, organizations and, in the 1990s, global governance (see GOVERNANCE, GLOBAL). Volker Rittberger, Mark Zacher and Oran Young are among those liberal scholars who have systematically explored how different regimes, such as those for trade, oceans, airspace, shipping, telecommunications, outer space and the Arctic, establish governance arrangements of varying scope and strength. Their work highlights the nature of the COLLECTIVE ACTION problems actors seek to solve through multilateralism, including jurisdictional rights and obligations, damage control problems, technical and procedural barriers, and market shares. These regime theorists perceive multilateralism as a reflection of states' mutual interests in cooperation in particular issue-areas, although the nature of regimes reflects divergent state interests, leadership and power relationships.

The realist school of thought in IR (see REALISM) has historically regarded international law and organizations as creations of idealistic statesmen or dominant states that shape the nature of the international order. With its emphasis on the anarchic nature of the international system, realism stresses that conflict is inevitable and cooperation is rarely durable. It offered little explanation for the twentieth-century expansion of multilateralism, however, until the emergence of NEO-REALISM and theories of HEGEMONY in the 1970s and 1980s. Although ROBERT KEOHANE and other scholars focused on the role of hegemonic powers in the creation of international regimes, John Ruggie and SUSAN STRANGE have been among those noting that it was a particular hegemon, namely the United States, that took the lead in creating both the League of Nations and the UN, as well as many other international organizations in the period after World War II. Hence, Ruggie argued, one had to explain why the United

States chose to use its predominance to create an international order marked by multilateralism. The further puzzle for HEGEMONIC STABILITY THEORY was explaining the persistence of post-World War II regimes after the decline of US hegemony in the 1970s. In the 1980s, neo-realist and neo-liberal institutionalists looked at how international institutions and patterns of cooperation change states' definitions of interest and perceptions of future choices, often using RATIONAL CHOICE and GAME THEORY to analyse states' decisions relating to different types of cooperation problems. Rarely, however, is the word 'multilateralism' used in this literature.

Other approaches used by scholars to explain the growth of multilateralism have looked at the role of ideas and norms, EPISTEMIC COMMUNITIES, and domestic factors. Constructivists have paid particular attention to ideas and norms as factors shaping definitions of interest and identity, as well as the nature of regimes. The learning of new norms and patterns of behaviour, and the emergence of new identities, can be critical to the development of multilateral institutions. Epistemic communities of experts have been influential in shaping understanding of certain problems, possible solutions and outcomes of multilateral negotiations. Climate scientists, for example, have been key actors in negotiations on global warming. In addition, scholars have debated the role of domestic structures, actors and policies, levels of democratization, and transparency. In many cases, global problem-solving has been linked to building the capacity of local governmental institutions and strengthening the participation of CIVIL SOCIETY. One influential approach introduced the concept of two-level games associated with the domestic ratification of international (but not always multilateral) negotiations.

Advantages and disadvantages of multilateralism

The growth of multilateralism has affected all states and, arguably, peoples. However, theoretical and value preferences, as well as the size

and level of development of states, shape answers to the question of multilateralism's effects. Among liberals, there has historically been a common assumption that the growth of multilateralism is progressive and positive. Yet critical voices have cautioned against this view in both normative and empirical terms. Aggressive alliances, international crime syndicates and drug cartels exemplify the malign possibilities of multilateralism, as Susan Strange has noted, especially if the term is applied to interactions between non-state actors. The deepening of inequality between rich and poor in the world belies the liberal assumption that multilateralism will necessarily promote economic well-being and social justice for all, yet the expansion of the global economy owes much to the institutions of the BRETTON WOODS SYSTEM and regimes for shipping, air transport, telecommunications and postal services, as well as to states' mutual interests in international economic cooperation.

Although theories of cooperation hold that increasing numbers of actors result in lower probabilities of cooperation, institutionalized procedures have been shown to make cooperation possible even with large numbers of actors. Some issues, such as law of the sea, trade, ozone and global warming, require large-scale multilateralism to be addressed successfully. Coalition-building is a common strategy for dealing with the complexity of multilateral diplomacy and negotiation, as is informal consensus-building in advance of formal voting.

Although IGOs serve as instruments of statecraft for both large and small, powerful and weak states, and have some influence on all members, there is wide variation in these patterns as a result of differences in decision-making rules, structures and membership. Global conferences and UN General Assembly sessions enable majorities of developing countries and middle powers to build coalitions and shape outcomes. Weighted voting in the EU, the Security Council, IMF and World Bank gives major powers disproportionate weight, if not veto power, over decisions. The G-7 reflects the dominance of major industrial states over international economic relations. The creation

in the 1960s of the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) was an unsuccessful effort by developing countries to diminish that dominance. For the United States, the post-war international order marked by multilateralism was a reflection of its own political principles, a means by which to share burdens and build legitimacy. The difficulty for the United States (and any one state) is in the inability to control multilateral processes and rules once they have been established. Indeed, the trade and monetary institutions have weakened all states by making them susceptible to the power of global markets. Yet, for multilateralism to be good for small and large, weak and powerful, the United States (and other powerful actors) must adhere to the rule of law and practices of multilateralism that they cannot always control. The essence of multilateralism does not reside in the number of participants, but in the patterns of participants' behaviour.

ROBERT COX has been among the foremost scholars not only in analysing the historical forces shaping multilateralism, but also in asking how developments in multilateralism will influence global structural changes in the future and what these structures do to people's lives. Where the majority of earlier work on multilateralism was state-centred, Cox differentiates between that and civil society-centred multilateralism, asking how the democratizing influences of various transnational social movements (such as environmentalism, women's movements, human rights and ethnonationalism) alter existing structures (such as the polarization of rich and poor) to achieve greater social equity and participation in the future.

Variations in multilateralism

There are wide variations in the number of participants, geographic scope (global, regional, subregional) and purpose (from general to specific) of multilateralism in practice. Almost all IGOs are multilateral, but their membership, scope, degree of institutionalization, core principles and strength vary. Regime variation

has been linked to differences in types of cooperation problems.

Although equal participation and voting power are core principles of multilateralism, not all IGOs afford these. The UN General Assembly scores high on participation and voting rights, but the IMF and EU give larger, wealthier states greater weight in decisions. ASEAN acts only on the basis of consensus. Strong multilateralism requires states to accept collective decisions as legally binding and is most evident in the IMF, EU and WTO; most IGOs are weak in this regard. Many international organizations score high on diffuse reciprocity, offering a variety of long-term mutual advantages or gains from participation. Many are important arenas for collective legitimation of norms, negotiation of international rules and dispute resolution. Others, such as the ASIA-PACIFIC ECONOMIC COOPERATION FORUM (APEC) and AFR, serve primarily to build relationships where few previously existed, to create opportunities for discussion of shared concerns and, where possible, to build consensus.

In the IPE literature on trade, multilateralism is often associated with globalism or universalism and contrasted with REGIONALISM. Resurgent interest in regionalism in the 1990s led to fear that the expansion and deepening of the EU, the creation of the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), APEC, MERCOSUR and other regional trade groups would undercut the WTO-based trade system. This 'new' or second wave of regionalism (the first having accompanied the European Community's development in the 1960s) was also seen as providing developing countries that had not previously been members of the GATT-based system with 'stepping stones' to open markets and global economic integration.

John Ruggie entitled his book: *Multilateralism Matters* (1993). Indeed, multilateralism has become a widely accepted organizing principle and practice in world politics, affecting economic growth, efforts to address environmental degradation and prospects for peace. It may well change the future architecture of world

politics if those principles and practices continue to influence the behaviour of both states and civil society.

See also:

cartels, commodity; collective goods; debt management (DM); diplomacy; public goods

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MARGARET P. KARNIS

multinational corporations (MNCs)

'Multinational corporations' (MNCs) are companies that engage in production activities outside their home country. They have become major actors in the world economy, accounting for a significant share of global output and

international trade and investment. The growth of MNCs has raised questions about the coherence of national economies and the viability of exclusively national economic policies. It has also posed a challenge to labour, which has traditionally been organized on a national basis. Finally, the relationship between MNCs and host DEVELOPING COUNTRIES has been a major issue.

Definitions and terminology

There is no universally accepted definition of a multinational corporation. The earliest comprehensive study of the phenomenon, the Harvard Business School Multinational Enterprise Project, defined a US firm as a multinational if it was listed in the Fortune 500 largest US companies and had manufacturing subsidiaries in six or more countries. Subsequently the definition was broadened significantly, so that firms were defined as multinationals no matter what their size, as long as they operated in at least one foreign country. Apart from size and the extent of foreign operations, another key issue in defining a multinational is the question of control or ownership of foreign operations. In order for a firm to be so defined, is it necessary that it should own (or even perhaps have a majority share-holding in) overseas operations? Alternatively, is the crucial characteristic of a multinational that it controls overseas production which may be undertaken by an independent overseas firm under various types of subcontracting arrangements? The growth of such arrangements has led some writers to broaden the definition of MNCs to include firms that do not necessarily own overseas operations, but are the centres of control of a network of international production.

Just as there is no universal definition of MNCs, there is no single agreed term for them either. The earliest discussions of the phenomenon in the 1960s tended to use the terms 'multinational enterprise' or 'multinational corporation'. Some authors preferred to refer to them as 'international corporations' or 'international firms'. In the 1970s, the term 'transnational

multinational corporations (MNCs)

corporation (TNC)' came to be used and was adopted by the United Nations (UN) when it created the UN Centre on Transnational Corporations in 1974. The UN adopted the term 'transnational' in preference to 'multinational' at the insistence of certain Latin American and Caribbean states, who wished to distinguish between foreign-owned TNCs and joint-ventures of two or more participating countries, established as part of regional integration schemes for which they wished to preserve the term 'multinational corporation'.

Origins and growth

Although it was only in the 1960s that MNCs became a focus for academic study, subsequent historical research revealed that the origins of the modern multinational go back to the late nineteenth century, when a number of US, British and continental European firms first set up subsidiaries overseas. This expansion was facilitated by developments in transport, storage and communications, such as railways, steam shipping, refrigeration and temperature-control techniques, and the invention of the telegraph, which created a more integrated international economy. At the same time, the growth in the size of firms and important changes in the organization of capitalist enterprises enabled them to control activities over a much wider area.

Two world wars and the Great Depression slowed the growth of MNCs. However, the period after 1945 saw rapid expansion. Initially, this was dominated by US firms, but after 1960 the overseas operations of European firms grew rapidly, followed from the 1970s by the growth of Japanese multinationals. A new phenomenon which began to emerge in the 1980s was the growth of multinationals based in some of the NEWLY INDUSTRIALIZED COUNTRIES (NICs), which followed their success in export markets by setting up foreign subsidiaries.

Significance

There is no doubting the significance of MNCs in the world economy today. On the broadest

definition, it is estimated that there were some 37,000 MNCs active in the mid-1990s, with over 200,000 subsidiaries. Between them, these firms account for about a third of world production, three-quarters of world trade and employ over 70 million people. They are also particularly significant in terms of their share of FOREIGN DIRECT INVESTMENT (FDI) (the 300 largest MNCs account for 70 per cent of the total) and privately generated innovation (TNCs account for about three-quarters of capacity).

The scale of MNC activities only partly captures their significance. They also illuminate many of the key trends within the world economy. These include the vastly increased international mobility of capital, the replacement of market transactions in international trade by non-market transactions between the parent and subsidiaries of the same multinational, the homogenization of consumption patterns through the spread of Western consumerism, and the uneven pattern of capital accumulation on an international scale.

Theoretical approaches to MNCs

MNCs have always been a focus of controversy and it is not surprising that they have given rise to radically different interpretations. It is possible to divide the literature into two main camps: those who are broadly speaking supportive of MNCs and their activities, and those who are critical. Within each of these camps, it is possible to identify further divisions, particularly among the critics, between those who criticize the multinationals from a nationalist point of view and those who are critical of capitalist forms of production more generally.

The dominant approach to MNCs today is what is variously described as 'internalization theory' or the 'transactions cost' approach. This links the existence of MNCs to MARKET FAILURE, in the absence of which there would be no incentives to internalize transactions within the firm rather than carrying them out in the marketplace. MNCs are seen simply as firms which internalize activities across international boundaries.

There are three main sets of market failures which are particularly significant in the growth of multinationals. The first involve markets in intangible assets such as TECHNOLOGY or marketing skills. Thus, many MNCs are found in industries which tend to be either technology-intensive (such as pharmaceuticals and electronics) or advertising-intensive (such as tobacco and detergents). A second type of market failure arises in vertically integrated industries where there are only a few buyers and sellers, and which require large investments with long gestation lags. This is particularly characteristic of extractive industries, such as minerals and petroleum, which again have historically been a major area of TNC activity. A third set of market failures arise as a result of government policies which distort market processes. Thus, in many developing countries, an important factor leading to the growth of multinational investment in the past was the protectionist policies of host governments.

A broader interpretation of MNCs which draws on some of the insights of the transactions approach is the 'eclectic paradigm' of John Dunning. This sees foreign investment by multinationals as a result of three sets of factors: ownership, location and internalization advantages (OLI). In order for firms to become multinationals, they must first of all have some specific advantage (for example, in technology or brand name) that enables them to compete with local firms in foreign markets (*ownership advantage*). Second, before they will undertake production overseas, there must be some location advantage to production in the foreign market as opposed to domestic production (*location advantage*). This may be because of lower labour costs, tariff barriers or a host of other factors. Finally, in common with the transactions approach, there must be some factors which make it advantageous for the firm to undertake production abroad itself, rather than licensing a foreign firm to do so (*internalization advantage*). Only when all three sets of advantages exist will a firm become a multinational through engaging in production overseas.

Critical approaches to MNCs tend to see

them as subjects in their own right, rather than simply a response to market failures or particular configurations of advantages. Central to this is the view that international expansion is an important element in the competitive strategy of firms. These strategies can be either offensive or defensive. Firms may often invest overseas as part of a strategy of horizontal (taking over competitors) or vertical (taking over suppliers or customers) integration. In contrast to the dominant transaction cost approach, which sees MNCs as a response to market failures, critical approaches see them as creating market imperfections through their strategic behaviour.

More radical critics identify MNCs as the latest manifestation of IMPERIALISM, seeing them as a systemic part of the development of capitalism. Here the emphasis is less on the strategies of individual firms and more on the laws of motion of the capitalist MODE OF PRODUCTION, which require firms to expand to new markets and to acquire new sources of raw materials and labour power.

MNCs and national economies

A major issue which has been raised concerning the growth of MNCs is the implications for the implementation of economic policies at the level of the nation-state. Since the late 1960s, the threat to national sovereignty posed by the growth of MNCs has given cause for concern. In 1969, Charles Kindleberger wrote that 'the nation state is just about through as an economic unit' (1969: 207). The international flexibility of MNCs enabled them to move funds and goods around the world, freeing them from national economic controls. This meant that the traditional fiscal and monetary policies were increasingly ineffective and that balance-of-payments problems were exacerbated by the ability of MNCs to manipulate TRANSFER PRICING. In other words, the feasibility of traditional Keynesian policies at the national level came increasingly into question.

At the same time, it has been pointed out that the growing significance of multinationals has given them a greater say in the formulation

multinational corporations (MNCs)

of policy. This is seen by some as part of the formation of a TRANSNATIONAL CAPITALIST CLASS.

One response to the difficulties of controlling multinationals at the national level has been the call for some form of international regulation. The UN has spent more than two decades discussing a code of conduct in this area. However, conflicting interests among member-states and the influence that the multinationals themselves were able to exercise, prevented any agreement being reached on a mandatory code. Moreover, the collapse of the Soviet bloc after 1989 and the increasing concern of developing countries to attract, rather than regulate, foreign investment, effectively reduced the governmental demands for stricter controls. The more recent discussion of a MULTILATERAL AGREEMENT ON INVESTMENT (MAI), under the auspices of the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), is focused much more on providing guarantees to foreign investors on the part of the signatories, than on creating instruments for the effective control of multinationals at the international level.

MNCs and labour

The growth of MNCs also presents a challenge to labour, which has tended to be organized on a national basis. The international spread of operations of multinationals enables the MNCs to play off workers in one subsidiary against another. Indeed, some writers see a strategy of 'divide and rule' vis-à-vis their workers as one of the motives leading firms to operate internationally. Even where this was not a causal factor in international expansion, there is no doubt that MNCs can use their multinationality to their own advantage.

Although a number of studies have found that the subsidiaries of multinationals pay higher wages than their local counterparts, this is often a reflection of higher productivity. The difficulties for labour of bargaining with multinationals arise partly because workers in a subsidiary lack access to the ultimate locus of decision-making at head-office. They also may

find it difficult to ascertain the true economic circumstances of the subsidiary in which they work, because of the effects of transfer pricing and other forms of inter-affiliate transactions which occur outside the marketplace. The problems are most acute in times of retrenchment, when multinationals are able to use the threat of withdrawal or transfer of part of their production to other countries, in order to gain concessions from their workforce.

At one stage there was considerable optimism that the internationalization of capital would automatically lead to a corresponding internationalization of labour. Despite the existence of several international federations in the post-war period, this expectation has not been fulfilled. It has come to be recognized that there exists a fundamental asymmetry between labour and capital, arising from the ways in which labour is divided by language, by distance, by differences in forms of union organization and by ideology. Whereas capital tends to expand across the world economy, the tendency is still for labour's struggles, and sense of community and identity, to be locationally specific. MNCs, far from equalizing conditions internationally and hence contributing to a unified international labour movement, are adept at exploiting these differences among labour to their own advantage.

MNCs and developing countries

A third major issue in the debate on multinationals is their impact on host developing countries. To put this in context, it should be remembered that the bulk of the activities of MNCs are concentrated in the advanced industrialized countries and only about a quarter of foreign investment goes to developing countries. Nevertheless, the scale of their activities often makes MNCs significant actors in developing economies.

The early expansion of MNCs in Latin America, Africa and Asia was very much focused on the extraction of raw materials, particularly in mining and petroleum, and to a more limited extent through plantation agriculture. After World War II, there was a

growing interest in some of these countries as markets, particularly when protectionist policies cut off access to them for exports from the MNCs' home base. Finally, since the 1970s, there has been a significant growth in the use of these countries as locations from which to export manufactures (and some services) based on locally available low-wage labour, or other incentives provided by the state.

The implications of the growth of multinationals for host countries differs widely according to theoretical perspective. The conventional view emphasizes the positive contribution which such firms can make. These include the provision of capital and technology, the generation of exports through offering access to foreign markets, and the creation of additional employment opportunities. More generally, it sees MNCs overcoming market failures and thus contributing to a more efficient allocation of resources.

Critics, while not necessarily denying the potential benefits of MNCs, point to a number of negative effects which, if there is not adequate state regulation, will tend to outweigh any positive contribution. MNCs command considerable market power, which they may use to the detriment of local competitors, consumers and host governments. They may earn high profits which are not declared locally, but rather repatriated through the manipulation of transfer prices. This leads to higher prices for consumers and deprives the host government of tax revenues. They may employ various forms of restrictive business practices to increase their market power, forming CARTELS or engaging in informal collusion through market-sharing arrangements or the allocation of spheres of influence. They are also a threat to local firms, not necessarily because of any superior efficiency but simply because they are supported by the 'deep pockets' of their parent companies. They also create demand for their products which may be inappropriate for local conditions, as in the much publicized case of infant formula milk powder.

Marxist critics of the multinationals agree with many of these points, but are sceptical regarding the prospects of effective regulation

being possible. They see the 'drain of surplus' from developing countries as inherent to the functioning of the capitalist system, so that it would be unrealistic to think that this can be avoided through state intervention. Moreover, the penetration by multinationals in developing countries tends to promote a COMPRADOR bourgeoisie who have little independence from international interests.

Over time, the dominant view of MNCs in developing countries has shifted considerably. Until the late 1960s, orthodox approaches dominated and tax holidays and incentives were used to attract foreign investment. By the late 1960s, more critical perspectives had gained influence and extensive efforts to regulate multinationals at both the national and the international level were made during the 1970s. Since the late 1970s, however, there has been a return to more positive evaluations of MNCs, and policies to attract foreign capital have again been to the fore in the developing world.

See also:

multinational enterprise (MNE), structures and strategies of

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RHYS JENKINS

multinational enterprise (MNE), structures and strategies of

The modern world is populated with large enterprises bearing names that are household words all over the globe: Toyota, Exxon, Siemens and McDonald's, for instance, are recognized by the public on every continent. Yet each of these enterprises is actually composed of many different corporations created under the laws of a number of different countries. As a rule, what binds these corporations together as a 'multinational enterprise' (MNE) is the fact that they are connected through a common parent. The parent typically owns a controlling interest in the other units of the enterprise, formulates a common strategy for the enterprise as a whole, and provides a common pool of financial, technological and human resources to execute that strategy.

The strategies adopted by these MNEs vary over a very wide range. In some cases, including notably in the raw materials industries, enterprises are organized around a vertical structure: some units of the enterprise, for instance, have the task of producing the raw materials, while units in other countries process

the materials into marketable products, and still others distribute the product in markets around the world. Other MNEs display a much more horizontal structure: while drawing on the technological resources of the enterprise as a whole, units in different countries or different regions produce and market a similar range of products or services for their respective markets.

These MNEs, also referred to as MULTINATIONAL CORPORATIONS (MNCs) or transnational corporations (TNCs), have come to occupy a commanding position in the world economy. Enterprises such as these were already in existence early in the twentieth century, albeit in limited numbers. But in the latter half of that century, their numbers mushroomed, elevating them to a major place in international trade and investment.

Numerous variants on the parent-and-subsidary structure have served to blur the concept of the multinational enterprise, as well as the outer boundaries of specific enterprises. Some enterprises, for instance, bind subsidiary firms into the network through minority stockholdings rather than through majority holdings or outright ownership. Some, including especially those in retail trade, use franchises rather than ownership as a means of binding their retail outlets to the enterprise. Still others use foreign contractors and subcontractors to provide products and services in a long-term durable association.

MNEs commonly extend their reach beyond their immediate networks by entering into limited alliances of various sorts with other enterprises – alliances of a kind that allow the participating firms to retain their separate strategies and separate identities. Multinationals establishing a manufacturing unit in a foreign country, for instance, have frequently created a joint venture for the purpose, taking a local enterprise as partner in the venture. In such cases, the local partner has commonly overseen the local distribution of the product manufactured by the joint venture, as well as overseeing relations with the host government.

In the 1980s, alliances of various kinds among otherwise independent firms suddenly

began to grow sharply in number, with MNEs being especially prominent among the firms involved. Dubbed 'strategic alliances', these consisted of formal or informal understandings in which two or more firms pooled their efforts for some limited purpose, such as joint research in a specified area or joint manufacture of a specified product. These agreements are often ephemeral in form and of indeterminate duration. But many are sufficiently specific to be recognized and acknowledged publicly. Researchers have recorded thousands of these agreements, clustered mainly in high-tech industries like information technology and biotechnology. The parties in any such alliance have commonly been MNEs headquartered in a number of different countries. The effect of these alliances has been to link the leading enterprises of different countries in amorphous webs of interest that are not easily delineated.

The place of MNEs in the economy

One cannot measure precisely the quantitative importance of MNEs. Apart from the difficulties of defining their limits, the definition of such firms varies greatly from one country to the next, and the data generated by each country to measure their activities vary greatly as well. The bulk of the world's business, however, is done by a few thousand of the world's largest enterprises headquartered in a very few countries. These well-studied enterprises, practically all multinational in structure, account for about half the world's output and for even more of the world's international trade in goods and tradable services (such as banking and telecommunications). So, despite the statistical and conceptual handicaps, some plausible estimates of the activities of MNEs are possible.

Most multinational enterprises operating in global markets at the century's close have had their origins in the advanced industrialized countries, such as Germany, Japan, the United Kingdom and the United States; with very few exceptions, the parent firms in such enterprises continue to be located in their country of origin. According to UN estimates, over 90 per

cent of the FOREIGN DIRECT INVESTMENT (FDI) in the world is accounted for by parents headquartered in the advanced industrialized countries. Nevertheless, by the close of the century, many large firms headquartered in rapidly industrializing countries (such as Brazil, China, Korea and Mexico) had also joined the roster of MNEs by acquiring subsidiaries in foreign countries.

The advanced industrialized countries provide not only the home for most MNEs, but also the venue for most of the subsidiaries of such enterprises. About three-quarters of the FDI of MNEs, according to UN estimates, are found in advanced industrialized countries; transatlantic investments are particularly large, as are the investments of Japan-based multinationals in North America and Europe. As a rule, these investments are concentrated in industries with advanced technical requirements (such as electronics and pharmaceuticals), as well as in industries that rely heavily on trade names and advertising (such as food preparations and other consumer products).

Many countries outside the advanced industrialized world, however, have also come to rely on MNEs to provide a substantial share of their output, including not only industrial production but also power generation, communication services and banking. For instance, foreign subsidiaries of MNEs are estimated to be producing nearly three-quarters of Singapore's manufactures, while Latin American countries commonly attribute about one-third of their manufacturing output to such enterprises.

Special strengths of MNEs

Numerous studies have been undertaken of the performance of MNEs. In some studies, the MNE as a whole has been studied; in others, the performance of foreign subsidiaries has been the study's target. Sometimes, the object of such studies has been to determine whether MNEs were more efficient than state-owned enterprises or the enterprises of national entrepreneurs; sometimes, to determine whether they were more profitable, and, sometimes,

to determine other aspects of their relative performance, such as their employment practices and their environmental practices. Such studies have usually been handicapped by the difficulties of controlling for differences in industry-mix and other such variables that might affect their performance. Many of these studies have failed to find any credible differences. But a few basic propositions have survived repeated tests.

To the extent that credible comparisons can be made, MNEs as a class tend to be both more efficient and more profitable than either state-owned enterprises or the enterprises of national entrepreneurs. They also tend to provide higher wages and better working conditions than locally owned enterprises and to adhere to higher environmental standards than state-owned enterprises.

Economists looking for an explanation of the higher profitability and efficiency of MNEs usually attribute them to various kinds of factors. One of these is **ECONOMIES OF SCALE**: the ability of the MNE to concentrate its global or regional operations in a single facility wherever such a strategy would reduce costs. A second factor is the ability of units within the MNE to acquire foreign goods and services from an affiliated unit in another country whenever resort to public markets would be costly or inefficient. A third is the ability of the MNE to search effectively for threats and opportunities in global markets, using its units located in such markets as its eyes and ears. A fourth, building in part on the other factors, is that the MNE is able to reduce its risks through diversification of markets and sources, as well as through imitation of the investment patterns of the industry's leaders.

Relations of MNEs with governments

In the final decades of the twentieth century, most governments were eagerly seeking the technology and capital that MNEs seemed capable of providing. But the longer history of relationships between the governments and MNEs was punctuated with numerous incidents of conflict. Indeed, a wave of such

incidents had occurred in developing countries during the 1970s, leading to the nationalization of many hundreds of the subsidiaries of MNEs.

The root causes of such conflicts have continued to be present in the decades that have followed; but both governments and enterprises have apparently learned to manage them more effectively. Fundamentally, the conflicts have arisen out of the differences between the goals of governments and those of the MNEs. Governments seek to maximize the benefits from enterprise operations that can be realized on their own national territory (such as jobs, taxes and exports), but each unit in a MNE, wherever it is established, is charged with executing its assigned role in a global strategy. More often than not, the multinationals have executed their global strategies in ways that seemed to contribute to national goals rather than to thwart them. But clashes in the objectives of governments and enterprises have been inevitable at times, given the underlying differences in objectives.

In the execution of their strategies, MNEs frequently distinguish the home country of the parent in important ways from the host countries in which subsidiaries are located. Nevertheless, as a rule, all the countries in which an MNE operates are exposed to the possibility that the enterprise will feel obliged at times to shift the location of some activity in the execution of its global strategy.

One area in which tensions have persistently appeared is in the struggle over *jobs*. In the final decades of the century, MNEs were establishing and expanding numerous production facilities in subsidiaries outside their home countries. These were commonly supplying not only the national markets in which they were located but the markets of third countries as well. That development led to widespread claims in Europe, Japan and the United States that the enterprises were depriving their home countries of exports and jobs.

The struggle over jobs has also generated a competitive race among governments to attract the subsidiaries of MNEs, using subsidies and tax exemptions of various kinds in the contest. Subnational units throughout the world (such

as cities, states and provinces) have been deeply involved in the race. Claims have been common that MNEs were playing off one government against another in the competition, to the detriment of labour and other national interests.

Another policy area in which clashes have continued to be frequent is in the field of *taxation*. Most of the international transactions undertaken by units in any MNE are with other units of the same enterprise located in another country. Each of these units is obliged to determine a taxable profit, to be reported to the authorities in the country where it is located. To calculate such a profit, each unit is obliged to assign a 'transfer price' to each transaction with an affiliate. Such prices, especially when they involve an intangible asset such as the use of a foreign databank or of a trademark, usually have no market equivalent and must be simulated by the use of arbitrary standards. As a result, the profit calculated by the subsidiary is readily challenged by the tax authorities. Thousands of such cases were in dispute around the globe at the close of the twentieth century.

Another policy area that has produced frictions between MNEs and governments has been that dealing with *competitive practices*. From the viewpoint of relatively small national firms in competition with the units of MNEs, the size and geographical spread of those enterprises has usually seemed threatening, suggesting access to superior technology and to more plentiful sources of capital. Accordingly, even as governments in developing countries have sought to attract the subsidiaries of MNEs, they have worried that the competition of these subsidiaries might destroy national competitors. National governments, such as those in Brazil, China, India and Korea, have been constantly on the alert to protect their home enterprises, using subsidies, tax exemptions, administrative obstacles and other devices for the purpose.

Yet another area of policy that has produced conflict has been the treatment of industries bearing a relation to *national security*. Most countries restrict foreigners from holding a controlling interest in firms that are primarily

engaged in the manufacture of military goods, firms that operate radio or TV facilities, firms operating commercial airlines and firms engaged in banking; some extend their restrictions to cover other industries as well, such as trucking and shipping. Security also has been a consideration that has led some countries to monitor and control the activities of MNEs, including such enterprises headquartered on their national territory. The US government has been particularly aggressive in attempting to control the movements of high-tech products and their related technologies between US parents and their foreign subsidiaries. Official efforts of that sort have periodically stirred up bitter reactions on the part of foreign governments.

Other sensitivities to the activities of MNEs have differed widely from one country to the next. France and Canada, for instance, have taken measures to protect some of their 'culture' industries from the domination of media enterprises with headquarters in the United States. Groups in India have expressed their distaste for the promotion of beef products by foreign firms, such as McDonald's, as being an affront to the sacred attributes of the cow. Many countries have resisted the idea that foreign-owned subsidiaries in their jurisdiction, even though they were corporations created under local law, should be entitled to the same rights of political participation as corporations owned by nationals.

Relation of MNEs to non-profit organizations

With the growth of MNEs, various organizations engaged in promoting non-profit objectives, such as the control of the environment and the promotion of religious freedom, have sought to harness the economic power of those enterprises to their objectives. The pioneer case of that kind was the organized non-governmental efforts in the 1970s and 1980s to put pressure on South Africa to end its apartheid system. In later years, environmental groups repeatedly threatened multinational oil companies with boycotts on the grounds that

multiplier, foreign trade

they were polluting areas in developing countries. Other groups were putting pressure on multinational textile companies and shoe companies to stop using child labour in developing countries or risk boycotts in world markets. Still others were pressurizing MNEs to withdraw their units from countries with oppressive human rights regimes. By the end of the twentieth century, pressures such as these had become a significant element in the environment in which MNEs were operating.

International agreements and codes

The growth of MNEs has also triggered a wave of international agreements between governments of various kinds. Most of these have been consummated in response to pressures from MNEs and their home governments to smooth the way for the expansion of the enterprises into foreign countries. Prominent among such agreements have been several thousand bilateral treaties on investment, in which each government in the agreement guarantees some minimum rights to the other's nationals. From the viewpoint of MNEs, the most significant features of such bilateral agreements are the rights they accord such enterprises to set up subsidiaries or branches in a host country, as well as the guarantees they offer for the government's subsequent treatment of such subsidiaries. The right to set up subsidiaries or branches varies widely from one agreement to the next, but the treatment that each government guarantees to an established foreign-owned subsidiary or branch usually is 'national treatment' – that is, the same treatment as a national of the country would expect to get (see NATIONAL TREATMENT).

In addition to bilateral treaties of investment, governments have negotiated many hundreds of bilateral agreements affecting the application of their tax codes to the subsidiaries and branches of MNEs. These are designed to limit the possibility that each country, applying its own tax code, might tax the same dollar of profits, producing an overall tax rate that was confiscatory.

Apart from agreements aimed at smoothing

the course of the MNE, however, governments have also occasionally sought to develop a joint approach to problems that they did not feel free to tackle unilaterally. Illustrative has been a series of agreements among governments of countries in which international banks maintain their headquarters, defining the minimum capital levels that such banks should maintain in order to safeguard the interests of their depositors. There have also been, in the wings, numerous other proposals of a similar kind. For example, a group of countries that were home to many MNEs were in the process of establishing similar national laws that would criminalize the use of bribes by their enterprises in foreign countries. And discussions were going forward in the WORLD TRADE ORGANIZATION (WTO) over the possibility of developing a joint approach to mergers and acquisitions that might threaten international competition. The possibility seemed real, therefore, that an international system of jurisprudence might develop that particularly affected MNEs.

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RAYMOND VERNON

multiplier, foreign trade

The foreign trade multiplier is an extension of the closed economy multiplier (see CLOSED ECONOMIES) to allow for the effects of international trade. Like the closed economy multiplier, it shows the increase in income that will result from an increase in autonomous expen-

diture. However, because of leakage of part of the increase in demand into imports, the numerical value is smaller than that of the corresponding closed economy multiplier.

See also:

Keynesian economics: multiplier principle

J.S.L. McCOMBIE

multiplier principle

The 'multiplier' measures the extent to which an increase in aggregate demand in the economy increases total national income. Generally, national income will rise (or fall) by more than the initiating change in demand, because that change will itself generate further demand changes – a process that will be repeated several times. The final effect on the economy can thus be substantially greater than the initial stimulus, whether positive (the effect of an injection of spending on, for example, investment) or negative, with a contraction in demand exaggerated as it works through the system.

For example, consider a £1 million increase in government expenditure, which leads to growth in employment and total wages. Part of this increase will be spent by the recipients, generating further demand and new income for the producers of the goods and services purchased. This new income will in turn be partly spent, and the process repeated. Overall, if a fraction μ of the newly generated income is spent in each round (the rest being saved, spent on imports or taken in taxes), the eventual increase in national income will be:

$$\begin{aligned} & \pounds 1(1 + \mu + \mu^2 + \mu^3 + \dots) \text{ million} \\ & = \pounds 1(1/(1 - \mu)) \text{ million} \end{aligned}$$

where successive terms in the bracket on the lefthand side represent the dwindling fractions of the original injection spent in each round, an infinite series which sums to the quantity on the righthand side. The multiplier is thus given

by $1/(1 - \mu)$, yielding a multiplier of 4 if 75 per cent of income is spent at each round.

In this 'Keynesian' analysis of the multiplier, it is assumed that there are no inflationary pressures to cause part of the increased demand to show as higher prices. This is most plausible when there is slack in the economy. Increasing the sophistication of the model by inclusion of a monetary sector leads to more ambiguous multiplier effects.

JOHN CLARK

Mumford, Lewis (1895–1990)

Though not formally a political economist, aspects of Mumford's work are increasingly coming to the attention of students of international political economy (IPE). His writings on TECHNOLOGY, culminating in *The Myth of the Machine* (Mumford, 1967; 1971), which expanded and developed ideas developed in *Technics and Civilisation* (Mumford, 1934), have particular contemporary resonance. Mumford was originally interested in the human possibilities that sprang from humanity's organization into cities; possibilities which he observed were often compromised. Mumford sought to establish a more humane approach to the development and planning of cities, and suggested that the key problem for humanity, revealed by the organization of human beings into cities, was the impact of technology.

Lewis Mumford therefore made two key claims that are of interest to political economists concerned with technology. First, he traced technological history back to the invention or emergence of language. Language itself was the first technology, enabling man to coordinate and execute complex activities. Like Daniel Bell, Mumford accorded intellectual technologies an important role in social and economic development alongside physical technologies. But, for Mumford, this was not a post-industrial phenomenon – the first machines were rather the coordinated efforts of human beings. The vast labour gangs that built Stonehenge, the pyramids and other constructions of

Mundell–Fleming model

the ancient world were for Mumford ‘mega-machines’ whose components were people. Throughout human history – and most significantly *before* the emergence of writing – the technology of language enabled vast projects beyond the ability of any individual to be accomplished through coordinated labour. Mumford’s definition of technology required a longer historical treatment of technology to be developed, one that was not fixated on the physical traces of machines.

Second, Mumford distinguished between authoritarian and democratic technologies (Mumford, 1964). Authoritarian technologies were those that sought to control people, to limit and shape human desires and practices for purely economic ends. Democratic technologies, conversely, were those that promoted progress towards humanistic goals of emancipation and social benefit. However, technological development has, in the main, followed the path of control and authoritarianism. For Mumford, the modern NATION-STATE was the latest example of the mega-machine and its control of human endeavour for particular ends, dictated from the centre rather than emerging from the components. With the emergence of the information economy (see INFORMATION SOCIETY/ECONOMY), Mumford’s concern to widen technology from its material manifestation to include informational elements has taken on a new importance which has yet to be fully explored.

See also:

knowledge industries; post-industrialism; technology imperative

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CHRISTOPHER MAY

Mundell–Fleming model

The ‘Mundell–Fleming model’ is a model developed independently by Robert Mundell and J. Marcus Fleming in the early 1960s, shortly after they had been colleagues at the INTERNATIONAL MONETARY FUND (IMF). It is an essentially Keynesian model (see KEYNESIAN ECONOMICS) of an OPEN ECONOMY. Existing Keynesian open-economy models, developed during the 1940s and early 1950s, did not take account of international flows of CAPITAL. This reflected the insignificance of private capital flows during the period, due to the existence of a comprehensive set of capital controls (see CAPITAL, CONTROLS ON) put in place during World War II. As post-war international trade developed, capital controls came to be seen as an impediment to economic growth within the (capitalist) world economies. This led to a reduction in their extent and to a subsequent growth in private capital flows. By the end of the 1950s, it was apparent that the existing orthodox Keynesian open-economy models were inadequate and needed to be updated. The major contribution of the Mundell–Fleming model is its analysis of the impact of CAPITAL MOBILITY under different EXCHANGE RATE regimes on the effectiveness of fiscal policy and monetary policy (see FISCAL POLICY; MONETARY POLICIES).

In the Mundell Fleming model, it is assumed that there are two countries: a domestic economy, which is assumed to be small enough not to influence interest rates and the level of national income in other countries, and a large foreign economy, which may be thought of as 'the rest of the world'. In the model, a change in the capital account is generated by the existence of an **INTEREST RATE** differential between the two countries, under the assumption that the exchange rate is not expected to change. This implies that, from the perspective of the domestic economy, if the interest rate is higher than the world interest rate it will generate a capital inflow, and if it is lower than the world interest rate a capital outflow will result. The magnitude of the capital flow will depend on the degree of capital mobility that is assumed to exist. A high degree of capital mobility implies a large capital flow, for a given interest rate differential. The model also takes account of the impact of changes in the current account (equivalent here to the **BALANCE OF TRADE**). A depreciation or a devaluation of the currency of the domestic country is assumed to stimulate net exports and therefore improve the balance of trade (see **CURRENCY DEPRECIATION; DEVALUATION, CURRENCY**). That is, the **MARSHALL–LERNER CONDITIONS** are assumed to apply. It is also assumed that the level of domestic exports increases with national income levels in 'the rest of the world' (that is, with the level of international trade) and that increased consumption associated with increasing domestic national income increases the level of imports into the domestic economy. The Mundell–Fleming model is derived by incorporating the current and capital accounts (which sum to give the balance of payments) within a traditional Keynesian IS/LM model. In most versions of the model, a fixed price level is assumed.

The predictions of the model are very strongly influenced by the exchange rate regime – that is, whether they use **FIXED** or **FLOATING EXCHANGE RATES**. A monetary expansion in the model would be expected to lead to a reduction in the domestic rate of interest, since

this reduces the costs of borrowing it should stimulate an increase in investment expenditure, which in turn results in an increase in national income. If we assume that the current and capital accounts are initially in equilibrium, and that the exchange rate is fixed, this results in a deficit on both accounts. Falling domestic interest rates cause a monetary outflow on the capital account, while the increase in domestic national income leads to an increased level of imports and a resultant monetary outflow on the current account. This results in an increase in the supply of domestic currency on the foreign exchange markets. In order to maintain the fixed exchange rate, the domestic monetary authority must be willing to exchange foreign currency for the excess domestic currency, which causes the initial increase in the money supply to 'leak' abroad. The interest rate therefore rises back up to its original level, resulting in a reduction in investment and national income back to their original levels and therefore to balance-of-payments equilibrium once more. However, the monetary authorities may choose to 'sterilize', by offsetting the reduction in foreign exchange reserves by further increases in the domestic money supply. However, such a policy is only feasible in the short run, since foreign exchange reserves would eventually run out, necessitating a suspension of the policy or a devaluation of the currency. Therefore, an implication of the Mundell Fleming model is that monetary policy under fixed exchange rates will only have short-run expansionary consequences. Under floating exchange rates, the consequences of monetary policy are somewhat different. The initial consequences are similar: the increase in the money supply results in a fall in interest rates and an increase in national income. However, the increase in supply of domestic currency in this case results in a depreciation of the currency. The depreciation stimulates net exports leading to an increase in national income. Thus, under floating exchange rates, the initial monetary expansion is reinforced by the expansionary consequences of the resultant depreciation of the domestic currency.

mutual funds

The effectiveness of fiscal policy is also dependent on the exchange rate regime, but it is also influenced by the degree of capital mobility. A fiscal expansion in the domestic economy (such as an increase in government spending or a reduction in income tax) leads directly to an increase in national income and indirectly to an increase in the interest rate. This latter effect is due to the increased demand for money that results from the rise in the level of transactions in the domestic economy associated with rising incomes. If we again assume that both current and capital accounts are initially in equilibrium, the increase in national income will result in a current account deficit and a capital account surplus (as domestic interest rates rise). Which effect dominates the overall balance of payments will depend most significantly on the degree of capital mobility. If capital is highly mobile, the interest rate differential will generate a large capital inflow, resulting in a balance-of-payments surplus. Under fixed exchange rates, this will result in a monetary inflow which, unless sterilized, will lead to a fall in domestic interest rates and a resultant further expansion in national output. If capital is immobile, the fiscal expansion will only lead to a small capital inflow relative to the outflow on the current account, which implies a balance-of-payments deficit. The resultant monetary outflow will raise interest rates (unless sterilized), thereby reducing national income. Therefore, under fixed exchange rates, the impact of fiscal policy is strengthened if capital is mobile, but weakened if it is relatively immobile. If there is zero capital mobility, the effects of the initial fiscal expansion are completely reversed.

Under floating exchange rates this conclusion is reversed. If capital is highly mobile the increase in the domestic interest rate, which generates an increase in demand for domestic currency, will result in an appreciation of the currency. This appreciation reduces net exports and therefore causes a fall in national income. If capital is relatively immobile, the fiscal expansion results in a depreciation of the domestic currency (as there is an increase in

the supply of domestic currency) which improves the trade balance, resulting in an increase in national income. Therefore, under floating exchange rates, a fiscal expansion is strengthened by a depreciating currency if capital is relatively immobile, but weakened by an appreciating currency if capital is mobile. If capital is perfectly mobile, the effects of the initial fiscal expansion are completely reversed by the contractionary effects of a currency appreciation.

The Mundell-Fleming model is perhaps too simplistic and has been criticized on numerous grounds. Accordingly, it has been extended and amended over the years in a number of ways. However, despite its limitations, it remains the basis of most informed discussion within the media concerning open economy macroeconomics.

See also:

Keynes, John Maynard: sterilization

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PETER MACMILLAN

mutual funds

'Mutual funds' or 'unit trusts' are investment companies that pool money from shareholders and invest in a diversified portfolio of securities. On the liabilities side, mutual funds can be either open-ended or closed-ended. Open-ended funds allow for an unlimited number of shareholders and the ability to redeem shares at any time, based on their current market value.

Closed-ended funds have a maximum number of shareholders and restrictions on redemptions. In terms of assets, there are three broad types of mutual funds: stock or equity, bond or income, and money market funds.

See also:

institutional investors; portfolio investment

ADAM HARMES

Myrdal, Gunnar (1898–1987)

Gunnar Myrdal held numerous positions in academia, government and international organizations, including the Chair of Political Economy at Stockholm University. He believed the role of a political economist was to help alleviate pressing social problems through analysis and the formation of policy prescriptions, particularly those regarding DISTRIBUTION OF INCOME and wealth. His particular areas of interest included Sweden's depressed economy (1930s), US race relations (early 1940s) and poverty in underdeveloped countries (1960s). In each case, his primary concern was with the essential dynamics that gave rise to observed unequal distributions of income, opportunities and political power. Recognizing that the principles of political economy were not relevant to every time and place, he developed his own methodology from which he would offer statements of tendencies rather than universally applicable economic laws in analysing and prescribing policies for each society he studied. He subsequently offered policy prescriptions for Sweden, and later for the United States and underdeveloped countries.

Methodology

Finding standard economic theory to be inadequate for solving the problems with which he dealt, Myrdal developed his own holistic method for identifying the interrelatedness and cause-and-effect relationships between relevant demographic, economic, historical, political,

social and cultural factors particular to each society he analysed. These relationships were interrelated in such a manner that, in the process of change, factors (such as health conditions, labour productivity, family incomes) would improve or regress in a circular, CUMULATIVE CAUSATION manner in response to a change in one particular factor, and the improvement or regression would proceed at a cumulative (that is, accelerating) rate thereafter.

First, a change in one endogenous condition will induce a response in secondary endogenous conditions. These changes, in turn, are likely over the long run to stimulate further changes in related conditions as the interrelationships between conditions and changes create a cumulative causation process with the social system continuously moving away from any equilibrium position. Whether a policy's impact initiates a positive or negative movement depends on whether its initial impact has a favourable or unfavourable effect on the path of the society's DEVELOPMENT. For example, positive changes in one condition (say, an increased level of consumption for the poorest segment of a society) would result in secondary changes that improved another condition (worker productivity) which, in turn, promoted greater output and income, thereby completing the circular, cumulative causation process by reinforcing further increased consumption, the initial condition which had been affected. On the other hand, declining consumption levels for the poorest group would lead to reducing their labour productivity, thereby further reducing their income and health standard.

Myrdal argued that, while shifting values of certain variables (such as calorific intake per person) stimulate social change in one direction (positive or spread effects, or negative or BACKWASH EFFECTS), the ultimate resting place of the social system is not easily predicted. This is because:

coefficients of interrelation between all conditions in the social system ... and time lags ... usually are unknown ... [therefore] our knowledge of them is utterly imprecise.
(Myrdal, 1974: 730)

He believed that, through analysis, tendencies could be identified for the purpose of policy-making, but precision in forecasts cannot be expected.

Subsequently, he provided policy prescriptions that followed logically from his own values and methods of analysis – policies which would explain how virtuous ‘circular causation’ and ‘cumulative’ chain reactions of variables could be initiated. Regardless of the society he analysed, a common feature of Myrdal’s policy prescriptions was that he suggested no specific ideology which should be fulfilled. Instead, he adopted a pragmatic and responsible approach in prescribing specific redistribution measures to improve the well-being of the poorest members of each society he analysed.

Myrdal’s analysis of poverty in Sweden, the United States and underdeveloped countries convinced him that individuals and society could be reformed through carefully planned social engineering efforts designed to alter a country’s principal economic, political and social institutions so as to promote development in a circular, cumulative manner. Myrdal was a strong proponent of cooperation between the state and private sector, and argued that once a society believes social engineering will be beneficial the state must initiate a system of planning for ‘establishing goals, choosing means, fixing targets and implementing policies’ (Myrdal, 1960: vi). Such planning was intended to be pragmatic and non-ideological – developed from common sense and experience – rather than being dogmatic and based on sophisticated, but abstract, economic theory. Myrdal believed that each country should determine the extent of its state’s agenda, devising their own ‘elaborate variations of the theme’ (Myrdal, 1957: 42) based on differences in resource endowments, relations with other countries, history, religion, economic and other social factors.

He concluded that, in order to promote development, policy-makers should include an educational programme designed to change attitudes, arguing that attitudinal and institutional change had to precede changes in economic variables such as higher rates of

consumption, savings or investment. Recognizing that significant attitudinal and institutional differences existed between societies, Myrdal concluded that a common reform programme that would provide a panacea for any country did not exist. He believed that it was possible to overcome the opportunism and ignorance pervasive in some societies, so that the society could achieve a fuller and more dispassionate knowledge of itself and the world. In the process, education would change people’s attitudes so that they would become more rational, thereby becoming more able to understand the benefits of Myrdal’s proposed reforms.

Sweden

On completing his graduate studies in economics, Myrdal could be considered a neo-classical macro-economist imbued with the importance of economic theory for resolving ‘economic’ problems. Faced with contradictions between the prevailing emphasis on *LAISSEZ-FAIRE* policies in the early 1930s and his growing desire to engage in social engineering to promote reform, Myrdal knew he had to break from conventional wisdom to resolve Sweden’s socioeconomic problems. His genius was to recognize that an interdisciplinary political economy approach was necessary to resolve problems previously considered as being separate, but which he saw as interrelated. Recognizing that his theoretical bent was insufficient for providing a substantive basis for radical political and egalitarian social reforms, he developed his own method of analysis which integrated history, sociology and politics with economics. With this new approach, Myrdal sought to transform the Swedish economy in a ‘leftist, socialistic direction’ through a gradual, pragmatic approach in which ‘evolution takes the place of revolution’ (Myrdal, 1932: 23).

In the role of advisor to the Minister of Finance, as well as a member of four Royal Commissions and the Swedish Parliament, Myrdal was well positioned to work on the problems of national planning which focused on the interrelated problems pertaining to

monetary policy, unemployment policy and public works as related to fiscal policy. In the late 1930s, Myrdal turned his attention towards resolving Sweden's housing and family problems. The comprehensive framework for fiscal policy he prescribed and the macro-economic policies he championed included temporary deficit spending and publicly financed works projects that would later be phased out (following economic recovery), national economic planning, currency devaluation, redistribution of income sufficient to lift the lower classes out of poverty, and publicly funded programmes to create full employment. He believed deficit spending would stimulate the business sector through a multiplier effect (see **MULTIPLIER PRINCIPLE**), be feasible from a cost-benefit standpoint, not require raising taxes, and not create a debt that would jeopardize the government's fiscal soundness. To convince parliament to adopt his policy proposal, Myrdal emphasized the multiplier effect of an expansionary fiscal policy, arguing that a cumulative growth process would ensue that would serve to alleviate involuntary unemployment, while providing public goods which would be of some value to the country. During this process, those hired for public works projects would spend their wages, thereby increasing the demand for consumer goods. Meanwhile, the government would order materials and equipment for these projects from private firms who thereafter, in order to produce these goods, would gradually hire more and more workers that had previously been laid off. In their turn, workers would raise consumer demand further as they spent their wages, and the process would continue by further stimulating an expansion of economic activity.

Myrdal began developing deliberate, rationally conceived policies, whereby the state would actively intervene to correct pressing social and economic problems, believing that 'well-planned egalitarian reforms would be preventive, prophylactic, and thus productive' (Myrdal, 1975c: 9). In addition to fiscal policy recommendations designed to redistribute income, he wrote proposed reforms that shifted

Sweden towards socializing consumption through family-oriented, state-funded redistribution programmes. Some family policy reforms recommended were larger tax deductions for families with children, cash grants for child allowances, subsidies for pregnant women, public housing, publicly funded health-care for children, free school lunches and textbooks, free public day-care centres, loans to newly married couples in need, aid to orphans and children of widows and disabled men, an improved national pension scheme and a national dental service. Myrdal's research and policy prescriptions opened an era of social reform systematically focused on the **WELFARE** of children and the family. His efforts contributed to the establishment of similar programmes in the rest of the Scandinavian countries, as well as in the United Kingdom.

Another result of the efforts of Myrdal and his political economist colleagues was that Sweden became one of the first West European countries to recover from the **GREAT DEPRESSION**, at a time when most others were still mired in deep socioeconomic problems. Sweden's recovery was so successful that Myrdal's budget theories were subsequently adopted by many European governments and even in the United States, where they became an important element of the early New Deal. Overall, the contributions of Myrdal (and some of his Swedish colleagues) pioneered a new era of macro-economic theory and policy, and his analysis and policy prescriptions enhanced his own prestige.

United States and underdeveloped countries

Myrdal later was offered the opportunity to apply his political economy in two very different areas of the world. In the United States he analysed race relations, while in selected Asian underdeveloped countries he focused on the nature and causes of the poverty that existed there. In both cases, Myrdal began with an in-depth study of each society's history, identifying the unique socioeconomic conditions and the factors impeding development; he

defined 'development' as an upward movement of the entire social system. A typical finding concerned the vicious circle of conditions that perpetuated poverty. For example, he concluded that poor nutrition led to low productivity of labour, which had a detrimental influence on the output of food and consequently on the level of nutrition and labour productivity in both the United States and in the Asian underdeveloped countries. Low labour productivity and low incomes meant that savings for investment were minimal, while consumption levels (particularly food) were low as well. New equipment and other inputs (such as fertilizer) could not be introduced if people were incapable of extended periods of hard manual labour – in response, labour productivity and incomes remained low. Such situations were pervasive in underdeveloped countries. When their particular 'initial conditions' were also taken into account, development policies that had proven efficacious for rich Western countries would be, in Myrdal's view, ineffective in these poor countries.

For both the United States and Asian underdeveloped countries, Myrdal therefore prescribed radical redistributional reforms designed to improve the plight of the most impoverished segments of the population by reversing the growing inequalities in the distribution of income and opportunities. Myrdal continually advocated radical, comprehensive agrarian and educational reforms. He emphasized the need to reform 'soft states' – governments in underdeveloped countries that Myrdal considered as being corrupt and dominated by opportunistic upper-class members who regularly practised nepotism and favouritism while discharging their duties towards the poorer segments of their population. He was also critical of the rich countries for ignoring the poor, arguing that their neglect was for socio-political reasons that favoured commercial interests over the plight of the most impoverished.

Closing remarks

Throughout the last decades of his life, Myrdal

continued to argue in favour of his type of political economy. He derided neo-classical economists' strong technical bent (which neglected the non-economic factors he argued were important) and their policy prescriptions which had their roots in traditional NEO-CLASSICAL ECONOMICS – both of which he argued were irrelevant for nearly all countries not belonging to the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD). In particular, he criticized neo-classical policy-makers for reducing all problems to a matter of optimum allocation of resources and for assuming that efficiency and favourable economic growth would ensue following the establishment of competitive markets and private institutions. He encouraged all economists to become transdisciplinary by widening the scope of their research, and to become political economists by accounting for the role of human valuations in their research.

See also:

change, progressive; change, regressive; egalitarianism; equality; least-developed countries (LLDCs); race; social democracy; social democratic parties; Third World; underdevelopment; welfare state

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JAMES ANGRESANO

N

NAIRU see unemployment, natural rate of

NAPLES TERMS see less-developed country (LDC) debt management

national champions

'National champions' are business enterprises selected by the governments of NATION-STATES as representative of a national effort to be internationally competitive and therefore granted special favours, including both subsidies and firm- or industry-specific policies to favour their growth. National champion firms may be involved in basic industries (for example, iron, steel, shipbuilding), in the production of intermediate goods (for example, machine tools) or in industries using advanced technologies (for example, computers, telecommunications equipment, biotechnology). They are generally not in agriculture, food processing, mineral extraction or service industries.

The origins of the concept of 'national champions' can be traced to the work on French economic policies by three scholars: Andrew Shonfield, Stephen S. Cohen and John Zysman. In *Modern Capitalism* (1965), Shonfield wrote about the 'étatist tradition' in France and the rise of the 'mixed enterprise'. The mixed enterprise was a 'partnership of private and public capital' that made its debut in France after the end of World War I (Shonfield, 1965: 82). The relatively intrusive French state used these enterprises to carry out state policies. After World War II, many of these mixed enterprises in France became state enterprises when they were nationalized.

Shonfield went on to talk about central

planning in France and how it differed from central planning in the Soviet Union. Cohen took up the theme in his *Modern Capitalist Planning* (1969). In this book, Cohen also discussed François Bloch-Laine's idea of the *économie concertée* – 'the close partnership between the state and big business, aimed at managing rapid, but orderly, increases in output and productivity' (Cohen, 1969: 129).

Zysman, in *Political Strategies for Industrial Order* (1977) analysed the role of the French state in promoting the French computer industry. Zysman viewed the French state as pursuing three forms of policy:

the fusion of small firms and the creation of a national champion firm; the support of French exports in semi-competitive markets; the creation of internally protected markets for the national champion and other privileged firms, and the outright subsidy of these firms.

(Zysman, 1977: 77)

In the French computer case discussed by Zysman, the national champion firm created after the purchase of Machines Bull by General Electric was the Compagnie Internationale de l'Informatique (CII). The rationale for the support of national champions in France was to protect the nation from three weaknesses: French firms 'were too small, the French market was too limited, and American firms were subsidized by military and space programs' (op. cit.).

Similar policies would be pursued later by various European and Asian governments in industrialized or industrializing nations. The British, for example, created a national champion steel firm (British Steel), while the French pursued a policy of supporting two champions:

national debt

Usinor and Sacilor (until they merged). In Japan, the MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI) helped Nippon Steel and the other integrated steel firms to become internationally competitive by encouraging them to adopt new steel-making technologies. Even the Germans had their champions, such as Siemens in electronics or Volkswagen in cars, while trying to avoid national champions in other industries such as steel.

As recently as twenty years ago, the Asians and the Europeans were not sure whether they could catch up with the United States in advanced industries, because the latter's large, outward-looking and transnationally organized firms dominated those industries. They thought it might be necessary to favour large domestic firms in their efforts to establish themselves as multinational enterprises in their own right. The Japanese did this through the *keiretsu* system of horizontally linked firms; the Koreans did it by supporting the *CHAEBOL* firms – conglomerates that were, for the most part, privately owned and managed.

Now that the other industrialized countries have generally caught up with the United States in many industries, the Asian and European fears of being left behind may seem exaggerated. It is still a matter of dispute how much having policies that favoured national champions helped these other countries to catch up with the United States. Many scholars argue that such policies hurt the countries that adopted them more than they helped. In the new information technology industries, particularly, it is argued that size is no longer so much of an advantage, and that an outward orientation and a transnational presence is much easier to attain. However MICROSOFT and Intel are replacing INTERNATIONAL BUSINESS MACHINES (IBM) as the US national champions for the computer industry.

See also:

competitiveness of nations; economic nationalism; strategic trade theory

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JEFFREY HART

national debt

When a government runs a deficit, it borrows money (usually by selling bonds to the public) to cover the difference between expenditures and revenues. The sum of all outstanding past borrowings (net of repayments of principal) is called the 'national debt'. Persistent deficits lead to increases in the national debt, and hence to the amount of interest that must be paid on the national debt. Much of the concern about government budget deficits arises from their cumulative effect on the national debt, and thus on the government's interest obligations. Hence, the national debt and public deficit are intertwined.

In most of the Western economies, government expenditure and revenue both grew steadily in the period from World War II until the early 1970s. Thereafter, government expenditure grew faster than revenue, giving rise to persistent deficits. Today, the majority of economies, regardless of the state of their development, face problems from persistent deficits and, by extension, an increasing national debt. The national debt of many countries has reached alarming proportions in relation to GROSS DOMESTIC PRODUCT (GDP) (including, for example, economies in Latin America, South-East Asia, but also in Europe) and has created concern among economists and policy-makers.

Is the debt too large? Is the deficit a danger? These questions cannot be answered without taking into consideration many aspects of the economic policy a government is pursuing. Deficits can be useful in generating demand, but they can be dangerous when they generate excess demand.

Critics of budget deficits often assert that the burden of deficits falls on future generations, because deficits reduce national savings and national asset formation, reducing the levels of income available to future generations. The reason for this is the 'crowding-out effect' which results from intense competition for capital in the financial markets. The total demand for both business- and government-sought funds increases, which may lead to an increase in interest rates. Hence, public needs will 'crowd out' private ones and business growth will suffer, reducing the levels of income available to future generations.

High interest attracts foreigners who invest in government bonds. This process increases foreign indebtedness and the externality of the debt becomes a major problem if the additional income needed to pay the interest is not generated.

There is general agreement that there is no absolute magnitude that separates a useful deficit from a useless or dangerous one. A deficit that is mainly incurred to create public assets or public growth-producing services (for example, education) will clearly have a different significance from one that is incurred to produce transfer payments that help to sustain demand. The first type of expenditure might create future revenues needed to repay the national debt and additional streams of income which will sustain higher growth.

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PERSEFONI TSALIKI

National Industrial Recovery Act

The National Industrial Recovery Act (16 June 1933), passed in the aftermath of the GREAT DEPRESSION, introduced limited government business planning of the US economy. Under this voluntary scheme, which exempted participating businesses from the provisions of the Sherman Antitrust Law, industries drew up codes to control output and prices. The National Recovery Administration (NRA) monitored these codes, in part to safeguard the interests of labour and the consumers. However, the scheme attracted criticism that it served the interests of business, rather than the consumer; that it led to increased prices and did not even provide economic recovery. The Supreme Court declared the act unconstitutional in May 1935, but later legislation reintroduced labour protection.

See also:

corporatism

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FIONA VENN

national security state

The expansion and institutionalization of the state for the purpose of protecting and promoting national security throughout government and (as far as possible) society generally, can be referred to as the 'national security state'. Perhaps the most visible recent examples of this were the United States and the Soviet Union during the COLD WAR. In each of these countries, almost all governmental bureaux and institutions were devoted at least indirectly towards protecting the state from the other superpower and its alien ideology. In the case of the Soviet Union, one important (and arguably intended) side-effect of this was to provide further justification for the Communist Party's monopoly on power. The national security state also facilitated the regime's control over domestic society and vassal states in Central and Eastern Europe by justifying the maintenance of large military, police and intelligence forces.

In the United States, the national security state was seen in the creation of peace-time defence and intelligence establishments and the general mobilization of economic forces and national sentiments against the 'Red Menace' of what was seen as Soviet-led global COMMUNISM. This was manifested in a variety of ways. The MILITARY-INDUSTRIAL COMPLEX (MIC) (the alliance of the US armed forces and industrial suppliers of military hardware) diverted huge resources toward military infrastructure, research and development (R&D), and deployment of new weapon systems. Furthermore, the entire government was to varying degrees dedicated to deterring communist aggression and most large governmental spending programmes were justified on the grounds that they would help defend the nation against an attack by the Soviets or communist Chinese. More broadly, the effects of the national security state adversely impacted the lives of Americans and compromised the very freedoms that advocates of this state of affairs were hoping to defend. The most notorious example of this was the series of attacks on

communists by Senator Joseph McCarthy during the 1950s and the careers that were destroyed by his frequently false accusations that entertainers, academics and government officials were members of the Communist Party.

See also:

permanent arms economy

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PAUL G. HARRIS

national treatment

'National treatment' is the principle, enshrined in many modern multilateral and bilateral trade treaties, that national governments should treat foreign-owned companies and enterprises in exactly the same way that they treat domestically owned enterprises in law and conventional practice.

R.J. BARRY JONES

nationalism

'Nationalism' is often defined as a system of ideas that emanates from belief both in the existence of a special group – the nation – that possesses certain specific characteristics and that the norms and values linked to the nation are more important than other collective values and interests. The realization of the interests of the nation is seen as presupposing political independence. Political independence is to be realized through the control of a specific territory through a sovereign state. Nationalism has also been defined as a political

IDEOLOGY or principle which holds that state and nation should coincide – meaning that the physical borders of a state should correspond to the boundaries of a national population. To a large extent, nationalism can therefore be seen as an ideology of borders and boundedness. It is built on the idea that cultural and national identity should coincide with the political form of organization within a certain geographic area. Therefore, nationalism is preoccupied with representations and symbolism connected to territory/geography/homeland, as well as to social boundaries between 'us' and 'them'. Linguistically, the concept originates from the Latin verb *nascor*, meaning 'am born'.

Nationalism is sometimes described as the most forceful political ideology of modern times. This is because it has reached a super-paradigmatic status in the sense that nationalism has been the ultimate organizing principle for the international system as a whole, built on the distribution of territory between NATION-STATES. Nationalism is also strong in terms of its mobilizing potential. As has been pointed out by Benedict Anderson (1991), no other political ideology has to such a great extent been capable of mobilizing people not only to kill but also to die for the sake of its cause.

The nation is defined by TERRITORY or ETHNICITY. Although the emergence of nationalism as a political idea/principle is related to long-term historical processes (such as the reformation of the Catholic church and the rise of CAPITALISM and industrialism), its 'birth' is usually dated to the French Revolution and the epoch of enlightenment. In this form, nationalism tended to be inclusive, liberal, universal and built on citizenship as defined by territoriality. This is sometimes seen as the civic form of nationalism, first expressed in this form in the French Revolution. In this variety, nationalism is also directly linked to democracy and the will of the people as the ultimate root of legitimate governance, rather than authoritarian structures claiming to represent a divine order. In terms of defining citizenship, this version has based its determinants on territory – that is, anyone born on the

territory that is embraced by the state has the right to citizenship. Citizenship is then not determined by ethnic or cultural criteria. This principle has been termed *us solis* – the right of territory.

The other main principle has been formed by Romanticism, emanating from the idea that all nations are defined by specific, inherent characteristics. Nations are seen as eternal and primordially defined. This tradition is linked to the German Romanticism, reacting against the enlightenment. Johann Gottfried Herder (1744–1803) was the first thinker to develop an idea of national characteristics and the first to speak about 'folk culture' (for example, in the form of *Volkslieder*). This Romantic folklorism became a dominant feature of nationalism in the 1800s, nurturing a strong affection for folk language, folk traditions and so on. During this time, there was considerable interest in languages. Popular nationalism was often initiated by people who had language as their profession – that is, authors, journalists, priests, lawyers and so on. Here a cultural and particularist nationalism was born. Herder's main idea was that of cultural self-determination, defined by and based on the unique and learned characteristics of a people. It should be stressed that Herder's idea of particularism was not aggressive or expansionist. This form of nationalism, however, lies behind the principle of *ius sanguinis* in determining citizenship. According to this version, in order for an individual to receive citizenship, there is a need of blood ties to the nation – that is, national citizenship is seen as defined by primordial ethnic criteria.

Nationalism can be said to embrace this tension between universalism/inclusiveness and particularism/exclusiveness. Each particular nationalism includes both these aspects as two possibilities: each nationalism is both exclusive and inclusive at the same time. To a large extent, the debate on nationalism has circled around this question: the nation as a political contract or as spirit.

The issue of contention here is whether nationality and national identity are based on the subjective will of the population or are

nationalism

largely something more primordial, essential and inherited. In 1882, the French Orientalist Ernest Renan (1823–92) held his famous lecture '*Qu'est-ce qu'une nation?* (What is a nation?)', in which he defined the existence of a nation as a 'daily plebiscite' – that is, a solidarity based on the will of its members to belong to the community. In this school of thought, there is a voluntary aspect of nationality – that is, one can choose to belong to a nation.

Modernism

Most authors agree that nationalism expressed and manifested through processes of mobilization and related to the territorial state is a phenomenon intrinsically related to modernity and modernism. However, there is considerable disagreement on whether it is nationalism that creates nations and national identities or whether national identities are rather contingent on historical forms of identification, thus serving as a basis for expressing nationalism. Authors such as Ernest Gellner (1983) and Eric Hobsbawm (1990) have defined nationalism as creative of the nation. According to this modernist/functionalist perspective, nations and national identities do not exist by and of themselves, but are created through the forces set in motion by nationalist ideologies.

The modernist perspective has linked nationalism and definitions of the nation to modernization and to socioeconomic and political processes of change. Ernest Gellner has, for example, seen nationalism as a reaction against inequalities in the distribution of wealth and welfare. Nationalism is, in this definition, a reactive phenomenon. In this perspective, there is a tendency to emphasize the role of elites and leaderships. Nationalism is seen as either the result of elite manipulation and propagandism or the reaction of the relatively weak and marginalized strata of society.

Marxist theories have linked nationalism and the nation-state to the growth of capitalism. In Marxist and socialist discussions (see MARXISM–LENINISM; SOCIALISM), there has

been a heated debate of the relationship between nationalism and the petit-bourgeoisie, nationalism as false consciousness and the right of 'genuine' nations to self-determination. For many Marxist thinkers, nationalism is linked to the UNEVEN DEVELOPMENT of capitalism. The unequal relationship between centre and periphery is seen as one source of nationalism (see CORE–PERIPHERY MODEL). Another argument is that nationalism is related to the class consequences of the growth of capitalism.

In contrast to modernist interpretations, a perennialist perspective implies that nationalism as an ideology is modern, but that this ideology builds on pre-modern and pre-nation-state collective identities based on ethnicity. In this perspective, national identities follow previous forms of group identity. Nations are thus built on longer-term histories, traditions, symbols and myths. It is thus a perspective that is related to but not equal to primordialism, implying that nations are rather static categories of identity, simply continuing to exist throughout history.

What Anthony Smith (1986; 1998) calls 'perennialism' sees nations as persistent ethno-cultural communities, firmly rooted in time and place. Modernists rather see nations as creations and the history of nations as historicism, invented or constructed for present-day purposes.

FASCISM and Nazism are extreme and degenerated political projects of nationalism.

Constructionism

In contemporary theorization on nations and nationalism, there is by and large consensus that nations are not traits, but discursive practices in a constant process of construction and change. National identity is what we say it is, not an observable essence. National myths are real to the extent that people believe in them and act in accordance with them. One of the most prominent thinkers in this field is Benedict Anderson, who has argued that nations are 'imagined communities' – that is, they are not objective or factual, but exist in

the minds of people. Nevertheless, they are not to be seen as artefacts or as false. Rather, nations are real communities to the extent that people define themselves according to them and to the extent that such identification is meaningful. This constructionist approach bridges the modernist and the perennialist approaches in the sense that it does not see nationalism as merely functionalist reactions to socioeconomic change, but takes seriously people's sources of meaning, belonging and identity. Modernist, functionalist and instrumentalist approaches have tended to reduce emotions and sentiments of belonging and meaning to socioeconomics.

Nationalism and the state

Nationalism is thus an ideology intimately connected to the modern state system. It is the main state ideology, but also the ideology of national movements striving to establish a state. Nationalism has been the main ideology in official state discourses on homogeneity. In order for nation-states to function, an ideology of what the members of a nation have in common and what this nation is based on are required. State apparatuses have therefore homogenized their populations into national citizens. This has been done both through institutions (such as the education system, the army, the judiciary system and so on) and the content that these institutions distribute in the form of language, history, norms, values, traditions and symbols. Successful homogenization has also required distribution of welfare, in order to create loyal nationals and citizens. That is, in exchange for allegiance to the national state, the citizen receives some amount of economic welfare.

Through the questioning of grand narratives by POST-MODERNISM, and through processes of GLOBALIZATION, the future of nationalism has been increasingly questioned. Social, economic, political and cultural processes no longer take the borders of states for granted, so the role of the nation-state is necessarily changing. This also has implications for nationalism as an ideology and the nation as

the ultimate source of people's sentiments of identity and belonging. On one hand, this has implied a new rise of particular nationalisms – by some called 'ethno-nationalisms' – claiming self-determination for themselves and sometimes secession from existing state-structures. The wave of ethno-nationalism sweeping across the globe during the 1980s and 1990s has been of much concern academically, as well as politically, since it has been related to devastating wars and conflicts. On the other hand, identities are formed by processes of hybridization and creolization, which implies that through the mixing and mingling, new forms of cultural identities emerge.

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HELENA LINDHOLM SCHULZ

nationality of firms

Whether viewed from a liberal or Marxist perspective (see **LIBERALISM**; **MARXISM–LENINISM**), the prevailing approach in the study of **MULTINATIONAL CORPORATIONS** (MNCs) has been to treat them as relatively homogeneous, paying little attention to the nationality of the firm. MNCs have simply been undifferentiated as a product of **ADVANCED CAPITALISM**, regardless of their country of origin, and the focus has generally entailed debates about the distributional consequences of their behaviour in the **THIRD WORLD**. This tendency dates back to the original debates in the early decades of the century on the sources and implications of **IMPERIALISM** that took place between J.A. HOBSON, KARL KAUTSKY and, subsequently, V.I. LENIN. Less empirical attention in international political economy (IPE), by contrast, has been given to multinational corporate investment between the advanced industrial states.

Attempts to explain variation in firm behaviour in the field of IPE has stressed three alternative approaches. Limited work, generally confined to business schools, has examined the differing internal characteristics of firms and how that influenced their behaviour. Alternatively, studies in business schools have long considered the influence on the behaviour of multinational firms of the sector in which they operate. This work has found a place in the mainstream literature of IPE, a notable example being the work of Raymond Vernon (for example, Vernon, 1971; 1977). The third alternative approach, emphasizing the nationality of the firm, offers a potential source of major insights into the behaviour of MNCs. Such an approach emphasizes three discrete yet interrelated domestic factors that influence the

behaviour of firms. The first consists of the domestic values, culture or ideology that predominate in a home economy (from which the investment originates). Examples of such an approach include whether a country emphasizes technological autonomy as a primary goal (as in the case of Japan) or places a greater emphasis on the importance of social partnership (as has traditionally been the case in Germany) (see, for example, Samuels, 1994). A second component is the national institutional structures in which firms operate, such as the nature of the financial system. A third component considers the influence of economic interest group coalitions on MNC behaviour. (For a seminal example of this type of historical work, see Chandler, 1990. Such an approach was brought back into current vogue by the work of Michael Porter – see Porter, 1990, for example. For a more recent example of such work that systematically links domestic ideology and institutional factors to patterns of trade and investment, economic governance and finance, and research and development (R&D), see Doremus *et al.*, 1998.)

The novelty of an approach emphasizing the nationality of the firm lies in the linkage of domestic factors in the home economy to the differentiated behaviour of MNCs in international markets and host economies in terms of their strategies regarding patterns of trade and investment, or research and development. It thus extends traditional domestic-structure arguments beyond public-sector policies to private-sector actors, in challenging propositions central to contemporary arguments in the **GLOBALIZATION** thesis that contend that the pressure of liberalized market structures (see **LIBERALIZATION**) force MNCs to converge in their behaviour towards best practices.

See also:

multinational corporations (MNCs)

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SIMON REICH

nationalization

When economic activities are 'nationalized', they are established, controlled and carried out by organizations vested in governments or set up by governments and not by private individuals or groups. After World War II, nationalization policies were especially popular in the former Soviet bloc and were applied by many THIRD WORLD countries. In many developed countries, nationalization policies in this period had a very pragmatic character and were restricted to those economies considered especially suitable for nationalization, either for historic reasons or because of economic efficiency. The restructuring of the global political economy since the 1970s has led to a revision of nationalization policies towards PRIVATIZATION in both developed and developing countries.

See also:

communism; mercantilism; socialism; state socialism; state-owned enterprises (SOEs)

MEHDI PARVIZI AMINEH

nationalization of investments

Foreign investments are 'nationalized' (or 'expropriated') when governments seize them as deliberate acts of public policy, usually without paying compensation to the former owners. Such seizures became commonplace in the 1970s, especially in poorer countries with extensive natural resources. The seizures were often popular symbolic acts, pitting local governments against foreigners. The foreign firms were usually seen as large, rich and rapacious. The associated foreign governments were seen in similar terms and were often former colonial masters as well. The nationalizations thus showed that smaller, poorer nations could act decisively, even against the economic interests of dominant powers and former colonial masters. Nationalizations also offered some immediate economic benefits. Instead of receiving royalty payments or taxes, the nationalizing governments became outright owners of the raw materials and could reap all the profits from their sale. If some assistance was needed to produce or market the products, foreign firms could usually be found who were willing to play those roles for a fee.

For decades, foreign investors had been able to prevent such seizures, either by their own actions or with help from their home governments. Most natural-resource industries were dominated by a few large firms and they could act together to sanction countries that tried to seize their investments. Their home governments usually gave them strong backing. All that changed in the 1960s and 1970s when many more companies went abroad in search of profits. Their competition meant that foreign countries with rich resources (or rich domestic markets) could drive better bargains and had strong incentives to overturn older, less favourable arrangements. The companies themselves were no longer parts of tight-knit oligopolies and were no longer able to sanction nationalizing governments so effectively. Governments, seeing their firms divided, were less willing to invoke strong sanctions. These seizures left many resource-rich countries as

nation-state

major producers, controlling their own oil fields or bauxite mines.

There was, however, a price to be paid for these policies and a number of problems gradually became apparent, even to the most aggressive governments. First, the seizure of foreign property made new investments riskier and less likely. That was not so serious a problem as long as countries could borrow heavily abroad; it became much more serious in the 1980s when debts fell due. Second, local governments were rarely efficient producers. Their inefficiencies ate up most of the gains from confiscation. Third, these strategies were difficult to extend to manufacturing and service industries where continuous innovations and international relationships were critical. The result was that nationalizations rarely went beyond raw material and agricultural sectors. Their importance declined further in the 1990s, when LESS-DEVELOPED COUNTRIES (LDCs) became more interested in attracting foreign capital and wanted to establish a stable, low-risk climate for foreign investors.

CHARLES LIPSON

nation-state

The 'nation-state' is the ultimate organizing unit of the international system. It is based on a specific combination of territorial boundedness (the territorial state) and the linkages between territory and population. In terms of legitimating principles, the nation-state is based on the idea that 'nation' in terms of population and 'state' should coincide (see NATIONALISM). In principle and ideally, there is to be congruence between the state in its administrative capacity, its physical borders and the ethno-cultural composition of the population, whose citizenship coincides with its ethno-cultural identity. In reality, there are few states that fulfill these criteria.

State and nation

Although STATE and nation are often used interchangeably to the point of confusion, they should be kept analytically apart. While the concept of state refers to the politico-juridical sphere, the notion of nation refers to the politico-cultural sphere. In order to be accepted and recognized as a state in the international (or, rather, inter-state) community of states, an entity must have control over a specific territory. Furthermore, according to the classical definition made by the sociologist MAX WEBER, a state has monopoly over the legitimate use of violence. Hugh Seton-Watson (1977) has explained:

A state is a legal and political organization, with the power to require obedience and loyalty from its citizens. A nation is a community of people, whose members are bound together by a sense of solidarity, a common culture, a national consciousness.

(Seton-Watson, 1977: 1)

Samuel Finer (1975) has listed the following criteria for a nation-state:

- 1 The state is territorially defined and the population of the state is defined by territorial principles and boundaries.
- 2 The population recognizes a predominant organ of the state consisting of 'specialized personnel', both 'civil' (that is, the bureaucracy) and 'military' (forces backing the bureaucracy and state functionaries, by force if necessary).
- 3 The state is further internationally recognized and thus upholds international SOVEREIGNTY.
- 4 Ideally, the population should sense or develop some kind of common identity and a common sense of belonging – that is, what is commonly described as 'nationality'.
- 5 Also ideally, the population should share 'duties and benefits' (that is, the population upholds common rights and duties towards the state).

These last points thus correspond to the nation-building process or project: in creating these characteristics, a common national identity supposedly will take form.

Historical processes of nation-state formation

The origins of the nation-state are found in the Westphalian Peace (1648) and the processes which ensued. It was during this epoch that the territorially grounded state was established. Nationalism as a legitimizing principle first developed in the late eighteenth century and during the nineteenth century.

With the establishment and eventual spread of the idea of the 'nation-state' – that is, the modern state with its power emanating from the will of the sovereign people and with the citizens (the subjects of the state) equalling the nation – the concepts of 'state' and 'nation' have come to be used interchangeably. The international system of today is thus a system organized of so-called 'nation-states' or, rather, on the idea of the 'nation-state'.

The nation-state has developed in different directions during different historical time-periods, as well as in different contexts. In Western Europe, consolidated nation-states (such as the Scandinavian countries, England, France and Spain) emerged during the sixteenth century. These state-formations were typically built around strong monarchies. In connection to a nationalist, Romanticist wave of the 1800s, the nation-state was further consolidated. The oldest state-formations of Europe are usually labelled state-nations: the state preceded the nation and state-building processes occurred prior to the breakthrough of nationalism as an ideology and also to the idea of common cultural descent becoming prominent. Here, assimilation processes occurred from above. Despite long-term historical processes, state-nations have experienced difficulties in consolidating themselves, however. The conflict in Northern Ireland is one of the most bitter ethno-national conflicts in Western Europe. Also, in France and Spain, the overarching national identity is questioned

by different identity groups. Immigrant countries, such as the United States, could also be defined as state-nations. State-nations emanate from the idea that all citizens regardless of ethnic origin are to be integrated into the state.

The other ideal type is the nation-state, or national state, formed out of nationalist pan-movements, struggling to unite different groups of peoples perceiving themselves to share the same culture. Germany and Italy are usually the principal examples. Such nationalism, sometimes labelled 'unificatory nationalism', proceeds from the idea that a nation is ethnically and culturally restricted and that a split nation needs to be united in a state. This is a more particularist and Romanticist version of nationalism, building on ideas of inherent characteristics of the nation/people.

In Eastern Europe, the process of nation-building has often emanated out of the dissolution of empires in relation to World War I. Three empires have historically dominated Eastern Europe: the Russian/Soviet, the Habsburg and the Ottoman Empires. The Russian/Soviet Empire developed in the direction of a nation-state involving a larger repression of minorities than the relatively more loosely organized Ottoman and Habsburg Empires. The nation-states that succeeded the Habsburg and Ottoman Empires have themselves embraced the ethnic heterogeneity which constituted the empires. In the Soviet Union, the principle of the right of self-determination for minorities was used so as to mobilize support for the communist state (see COMMUNISM). However, the Soviet state was oppressive of many of its minorities and nationalities. The fall of the Soviet Union has implied the establishment of a number of new nation-states, as well as an increase of ethnic conflicts.

In Africa, Asia and the Americas, nation-states were established in the wake of colonialism, although in different epochs. The process was much earlier in the Americas and the nationalist movements there were to a large extent influenced by both the civil characteristics of the French revolution and the Romantic, popular nationalism emerging in Europe in

the 1800s. Here, it was the political elites of European descent that were the main leading strata of nationalist movements. Liberation nationalism was an important uniting and mobilizing factor. In Africa and Asia, DECOLONIZATION occurred only as a result of World War II. In this case, liberation movements mobilized around concepts of national unity, combining authoritarian, official versions of nationalism with popular Romanticism. The post-colonial state has had a difficult time consolidating in Africa and Asia. This has been related to both external and internal pressures. During the 1980s and 1990s, we have witnessed an upsurge of ethnic and national(ist) conflicts in post-colonial settings. Many times, these are caused by exclusivist politics of elites, not capable of providing welfare and security for a majority of the population of those states. Collapsing states have become a new concept in the 1990s, as states in post-colonial settings cease to function as administrative units and instead fragment into violent conflict between groups competing for state resources. Often, identity is an aspect in those conflicts.

The nation-state as a political/territorial arrangement was thus born in Europe, but has since spread throughout the globe and become the sole organizing principle of the global system. With the collapse of the Soviet Union, the number of nation-states represented in the UNITED NATIONS (UN) in the year 2000 reached almost 200. With processes of economic GLOBALIZATION, the future of the nation-state as the organizing principle of the international system is, however, increasingly questioned.

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HELENA LINDHOLM SCHULZ

natural resource ventures

'Natural resource ventures' are arrangements between firms and governments to develop mineral and oil deposits. Unlike manufacturing or service industries, the natural resources industry has been concerned with questions of title and ownership of rights. Joint ventures in exploration have also been a characteristic of the industry.

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ROBERT LOONEY

Navigation Acts

The 'Navigation Acts', sometimes called 'Acts of Trade and Navigation' but more properly called the 'British Acts of Trade', were legislative measures enacted by the British government to favour English shipping and trade. The early acts, most infamously that of 1651, were directed in particular at the goal of crippling the shipping of the Dutch. In the early 1600s, the Dutch had developed the strongest merchant fleet because of its mastery of superior seafaring technologies. The Navigation Act of 1651 was therefore an important part of the English arsenal of mercantilist devices (see MERCANTILISM) to favour the English merchant fleet and English trade. It mandated, first, that goods exported from European countries could be shipped to

England and English colonies only on English ships or on ships from the port where the goods originated (ships of 'first-port'); second, that goods exported from an English colony could be shipped to England only by English ships or by a ship from the particular colony, and, finally, that English coastal trade and trade in fish was reserved exclusively for English ships. English ships were defined as those constructed by English shipbuilders, sailed by crews that were 75 per cent English and owned by Englishmen (by nationality, irrespective of residence, which became increasingly important as trade with the colonies intensified). This act therefore excluded the Dutch from trade in the Commonwealth, except for goods from the United Provinces. The act was an important cause of the First Dutch War in 1652.

The act was re-enacted in the First Navigation Act of 1660 and its coverage was expanded in legislation in 1662, 1663, 1670 and 1673. The acts of 1660 and 1663 are particularly notorious. The former established English monopoly over certain colonial produce (particularly indigo, tobacco and rice) by mandating that colonies could export these goods only to other colonies or to England. The latter mandated that all goods shipped to the American colonies pass through English ports (where they would be taxed). Smuggling ensued, but the acts were enforced loosely due to England's preoccupation with events elsewhere. After 1764, the English intensified policing of the acts, which (along with the increase in duties and taxes) caused resentment in America and is cited among the factors leading to the American War of Independence.

Though English trade increased substantially during the life of the acts, critics point out that this probably would have occurred in any case, particularly in later years, given that the INDUSTRIAL REVOLUTION began in England. English goods – particularly those of the colonies – also would have been more competitive had they been freed from the taxes imposed by the acts. The Navigation Acts finally were repealed in 1849 and 1854, as part of the general liberalization of the English economy as its dominant commercial position

was established. This, along with the repeal of the CORN LAWS in 1846 and Gladstone's Budget of 1860 (which abolished most import duties), are generally taken to herald the demise of the practice of mercantilism and the ushering-in of the period of generally FREE TRADE in Europe.

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JARROD WIENER

neo-classical economics

Neo-classical economics is the contemporary orthodoxy in economics. It is distinguished, first, by an assumption that economic actions are instrumentally motivated: actions follow from a calculation of how best to achieve the objective which motivates the agent (for example, individuals act to maximize the satisfaction of their preferences and firms act to maximize their profits); second, its analysis focuses on equilibrium states. The most powerful application of this approach has been in the study of market economies. These are economies where agents trade with each other in a decentralized manner – that is, without any form of central guidance or government direction. Thus neo-classical economics demonstrates that, under certain conditions, a market economy achieves a coordination of economic activity (that is, demand for each commodity is equal to its supply) and that the associated allocation of resources is efficient (in the sense that there is no reallocation of resources that could make one person better off, without making another person worse off). Whether these results tell in favour of market economies is a matter of some controversy. Most recently the approach has tended, however, to focus on cases of market failure, particularly those that arise because agents are poorly informed. Although it is natural to

think of market relations in connection with the production and sale of commodities, it is a mark of the power of the neo-classical approach that it has also been applied to other aspects of social life, notably by the public choice theorists and the Chicago School (see CHICAGO SCHOOL; PUBLIC CHOICE (PC) THEORY). Indeed, such is the dominance of neo-classical economics that the application of its approach to such issues as crime, marriage and divorce is often simply known as the 'economic' approach.

Individuals, firms and competitive markets

In modern societies, there is a division of labour. People specialize in the production of one (or a few) commodities that they sell to others in order to consume a wide range of goods and services. This creates a coordination problem: how are the individual production-decisions that combine to determine how much is produced of each individual commodity coordinated with the sum of the individual demands for each commodity? Can this co-ordination be achieved without the design of some central agency that plans and directs individuals to the various activities? These questions occupied much of neo-classical economic thinking in the twentieth century and are the concern of what is called GENERAL EQUILIBRIUM theory.

Neo-classical general equilibrium theory sets about answering the question of coordination in a particular way. It assumes that:

- 1 the economy consists of individuals and firms;
- 2 individuals are endowed with given stocks of the factors of production (for example, labour, land, capital goods and other resources) and firms produce final goods and services using these resources and a given production technology;
- 3 individuals decide on which resources to supply and which final goods to demand by seeking the combination of sales and demands that best satisfies their preferences, and

- 4 firms decide what resources to demand and how much output of final goods to supply by calculating what combination maximizes profits.

Assumption (2) is noteworthy because it establishes what the theory takes as given (that is, the distribution of a given set of resources across the population and the production technologies). Assumptions (3) and (4) embody the idea that agents in the economy are instrumentally rational: they have objectives and they select those actions which serve those objectives best. In the case of firms, the hypothesis that firms maximize profits needs no elaboration (save to note that neo-classical theory sometimes adopts different assumptions regarding firms' objectives when this seems appropriate, like revenue maximization and wage-income maximization when firms are run, respectively, by managers and workers). The case of individuals is perhaps worth further comment. Individuals have preferences over outcomes – this means that they can compare and rank the various combinations of goods and services, and they select the combination that satisfies best those preferences. The ability to compare and rank outcomes in this manner is also often described through a series of axioms; it is also capable of being represented as utility maximization, although it is important not to read anything deeper into the term 'utility' in this context. A 'utility' function for this purpose simply assigns numbers to outcomes such that the outcome that is most preferred receives the highest number, the next most preferred receives the next highest number and so on. Thus, maximizing 'utility' (defined in this way) is just an alternative way of describing action that is designed to maximize the satisfaction of one's preferences.

Now suppose the individuals and firms buy and sell to each other through competitive markets (see PERFECT COMPETITION). That means each agent knows the price associated with every good (including the factors of production), no agent has an ability to influence these prices and any agent can buy or sell as much as they like of any good, given

the constraints of their endowments and the production technology. So each firm knows the price of inputs and outputs, and decides on the basis of a profit-maximizing calculation (given the constraint of its production technology) what factors of production to demand and what final goods and services to supply and in what quantities. Likewise, each individual knows the prices at which they can sell their given endowment of the factors of production and the prices at which they can buy final goods and services, and they decide on what to supply and demand on the basis of a 'utility'-maximizing calculation.

Is there a set of prices at which all the individual demands and supplies of different goods are such that the total supply of each final good and service and each factor of production equals the total demand for that good or factor? With certain, not especially restrictive, technical constraints on the types of production technology and preferences that individuals can have, neo-classical economics has shown that a set of prices will always exist that equilibrates each market where final goods and factors of production are traded.

This is an extraordinary result. It seems order can be created without any central design or plan. If individuals and firms trade with each other on competitive markets, then coordination can be achieved provided they go to work with the right set of prices. Not only can 'order' be generated in this way, but neo-classical economics has also demonstrated that the 'order' is Pareto efficient – that is, there is no reallocation of resources, leading to a different set of final goods and services being produced, that will make one person better off without making another person worse off. So, while no agent may intend to produce either coordination in the aggregate or an efficient allocation of resources, these results nevertheless occur. No wonder there is talk of the INVISIBLE HAND. Nor is this the end of the matter. Neo-classical economics has also shown that there will be a competitive equilibrium set of prices for each of the possible ways of distributing the initial stock of resources across the population. This means that discus-

sion of the equity of any competitive market equilibrium can be usefully separated from considerations of efficiency. Competitive markets ensure efficiency and getting the initial distribution of resources 'right' is what will ensure equity in such an economy.

The rigorous proof of the existence of equilibrium and the two further results with respect to efficiency and equity (which are sometimes referred to as the fundamental theorems of WELFARE ECONOMICS) represent a culmination in the 1950s of a programme of research that began with Walras at the very start of the twentieth century. The basic idea, though, that markets guide economic behaviour with an invisible hand is (of course) much older, stretching back to ADAM SMITH.

Competitive general equilibrium and the analysis of market economies

While general equilibrium theory has established the qualitative properties of competitive economies described above, it has been less successful, except in very special economies, in generating more specific propositions with respect to the details of how a competitive equilibrium will change when there is some exogenous change like a technological innovation or a change in the supply of a particular resource. In simple economies, where there are only two factors of production and two final goods, there are some celebrated results that have formed the backbone of neo-classical TRADE THEORY. For example, the Heckscher-Ohlin proposition (see HECKSCHER-OHLIN-SAMUELSON (HOS) MODEL OF TRADE) that, with free trade, economies will specialize in the production of the commodity that uses their relatively abundant factor of production relatively intensely in production, is a piece of applied general equilibrium analysis. Likewise, there is the result that a tariff on a commodity will improve the price paid to the factor of production that is used relatively intensely in the production of that commodity. But, alas, few results generalize simply to more complicated economies.

It is perhaps not difficult to see why general propositions have been difficult to generate. In general equilibrium, everything depends on everything else and when the numbers of goods and factors increase beyond a few, these interactions can ramify in a variety of complex ways to weaken general propositions. Indeed, it was precisely these difficulties that were at the heart of the Cambridge capital controversies of the 1960s.

Nevertheless, the qualitative properties remain and they have been a rich source for discussions concerning the merits of a market-based economy. At first glance it may seem that these properties tell strongly in favour of a market economy. After all, it seems that the 'existence result' tells against the need for any form of central planning to achieve coordination and that the 'efficiency result' tells against any intervention in the operation of markets to achieve an equitable result. If equity is a concern, then it is best tackled through changing the initial distribution of resources and not through interference in the market by taxing this or that activity or through subsidizing this or that commodity. Indeed, this is precisely why there are arguments for MARKET SOCIALISM, as well as the more familiar capitalist version.

However, further reflection suggests that the issue is not so clear-cut. The problem is that a competitive economy is an artifice and most market economies are a very different species. So it is wrong to assume that the properties of the one also attach to the other. Indeed the neo-classical results could be read in exactly the reverse way. What has been demonstrated is that markets only generate these desirable properties under very restrictive competitive conditions. So it is exceedingly unlikely that any recognizable form of market system would actually enjoy such properties.

What are the restrictions that make competitive economies worryingly artificial in this respect? There are three that are worth mentioning. The first is that there is no account of how the equilibrium set of prices is generated (and this is why neo-classical economics is sometimes criticized for dealing only

in equilibrium states, without explaining through an analysis of disequilibrium how such states are achieved – see NEO-CLASSICAL ECONOMICS, CRITIQUE OF). The metaphor of an auctioneer is often used to describe how markets might grope towards the equilibrium set of prices. It is 'as if' an auctioneer called out a set of prices, calculated the supply and demand for each good, and then adjusted prices accordingly in an iterative process that continued until a set of prices generated demands equal to their respective supplies. But, in the absence of an auctioneer, it is not obvious from the theory itself how equilibrium prices will be generated. The natural strategy might be to allow for individuals or firms to set prices. But this means a change to the competitive assumption that agents take prices as given, which is unlikely to be innocuous in its effect because firms and individuals behave markedly differently when they can set prices. In fact, it is still possible to prove the existence of an equilibrium set of prices for certain models of imperfect competition, but the outcome is inefficient (see GAME THEORY).

Second, it seems most unlikely that agents in an actual economy know the price attached to every good and factor of production. In a complicated economy, there are literally thousands of prices and no one can be expected to know them all. In fact, this is not the only problem: some prices simply may not exist because some markets do not exist. For example, consider a firm's decision regarding investment in a new piece of machinery to produce output over a number of future years. Typically, there are no futures markets for most goods that would allow such a manufacturer to see what price these goods can be sold for in the future. In other words, in practice most agents are probably quite poorly informed about the trading possibilities, particularly in the future, and so must form expectations instead (on the possible consequences of this, see KEYNESIAN ECONOMICS).

Third, there are many resources and goods that are imprecisely owned and this can lead to their suboptimal use in a market economy (see PUBLIC GOODS). For example, consider the use

by motorists of the air that we breathe. Notice, in the absence of government intervention, the use of the air is free to motorists because no one owns this resource. Now suppose each individual motorist prefers a situation where everyone fits anti-pollution devices, even though such devices are costly, because clean air is so much better for breathing than polluted air. Will this lead a typical instrumentally motivated individual to fit an anti-pollution device? No. To see why, imagine the thought process of a typical individual. If they do not expect others to attach devices, then there is no point in attaching one because the device is costly and there will be no perceptible improvement in air quality (as one device has no effect on air quality). Alternatively, if they expect others to attach devices, then again there is no point in attaching one because the device is costly and the failure to attach will have no perceptible adverse influence on air quality (as the absence of one device has no effect on air quality). Thus, whatever the typical individual expects others to do, the best course of action is not to install the anti-pollution device. With all individuals performing the same mental calculation, the result is a polluted atmosphere even though each would prefer a situation in which all fit the device to a situation in which no one fits them. This is an example of a **FREE RIDER PROBLEM**; such problems often arise when property rights are poorly defined.

So in actual economies where agents set prices, information is inadequate and some property rights are poorly defined, the neo-classical analysis seems more likely to be a source of doubts over, rather than providing grounds for celebrating, the efficacy of actual markets.

Interdependence and economic behaviour when information is poor

Since the 1960s, neo-classical economics has turned decisively away from the analysis of competitive economies. It is now much more likely to model the economy as a set of strategic relationships and use the theory of instrumen-

tally rational decision-making that has been developed for the analysis of such settings: game theory.

This shift is not difficult to understand, as it is a direct response to the evident gap between features of actual economies and the assumptions of the competitive model. In one way or another, all the above three respects in which actual economies deviate from competitive ones involve a recognition that agents interact strategically and this type of interaction is very different to the competitive type. A strategic interaction is an interaction where each agent knows that the outcome associated with any of their actions depends on the action of others. For example, when I drive on the left-hand side of the road, the outcome depends on whether the driver who is approaching me drives on the left or the right. Thus, when I decide whether to drive on the left or the right, I must form an expectation of what the opposing driver will do. This is a strategic interaction. The contrast with decision-making in a competitive economy is most marked because there is no need to guess what others will do in a competitive economy, as the variable that affects the relation between an agent's actions and outcomes is a price, and prices are given to agents.

In this section, I consider an example of what is sometimes known as the 'principal agent problem' where strategic interaction and poor information combine to create a **MARKET FAILURE**. The generic problem has attracted much attention among neo-classicals and it illustrates a general feature of neo-classical work in this area: an interest in how non-market institutions may help markets to overcome the difficulties created by poor information. In the principal agent problem, there is a 'principal' who is considering buying something from the 'agent' – often the agent's labour. What distinguishes this type of exchange is that (1) the 'agent' has some discretion over the quality of the good they sell or how well they perform the service and (2) the 'principal' cannot easily monitor the quality of the good or the performance of the service (for example, when many people go to a doctor, they find it difficult to evaluate the

quality of the doctor's advice; likewise, when many people consider buying a second-hand car, they cannot judge its quality). The informational deficit in (2) means that the principal cannot make payment conditional on the quality/performance level and this can hinder the potential for a mutually beneficial exchange.

To see the origin of the problem in more detail, consider the case of a second-hand car dealer (the agent) who has cars of varied quality and who knows their respective qualities, and a potential buyer (the principal) who cannot judge the quality of a car. Specifically, the dealer has the choice of guiding the potential purchaser between good quality cars and 'lemons'. Suppose the dealer prefers to sell a 'lemon' rather than a good quality car to someone who cannot judge quality. This is not implausible, as it enables the dealer to keep the good quality cars for those who can tell the difference. In addition, suppose the dealer would nevertheless prefer a sale of a good quality car to no sale at all. The potential buyer has the choice between buying or not buying a car from this dealer and would like to buy a good car, but prefers to keep their existing vehicle rather than buy a 'lemon'. Thus there is the potential for a mutually beneficial trade: as the dealer prefers a sale of a good quality car to no sale and the buyer will buy a good quality car. However, as things stand, the deal will not take place. Why? The dealer knows that if the person does buy a car it will not be because they know the quality of the car, so it makes no difference to the likelihood of sale if the dealer guides the buyer to the 'lemon'; since the dealer prefers to sell a 'lemon' to a good quality car, the dealer will guide the buyer to a 'lemon'. The potential buyer can work out that the dealer will want to do precisely this, and since the potential buyer does not want to buy a 'lemon', they give the dealer a miss.

The dealer's situation is sometimes described a MORAL HAZARD (because the claims of self-interest and morality seem to conflict) and the problem is that the potential buyer cannot TRUST the dealer not to act 'opportunistically' (to use an expression from Williamson, 1975).

There are a variety of ways in which the problem of opportunism might be overcome. For example, if car dealers offer a warranty and then they will not want to sell a 'lemon' as they would become liable for the costs of its repair. Knowing this, a buyer is willing to buy a car from the dealer. Alternatively, if the exchange is repeated and a dealer acquires a public reputation regarding the quality of their cars, then the dealer will want to nurture a reputation for selling good quality cars as this reputation will encourage potential buyers in the future. Notice that many of these remedies require the presence of a non-market institution. For example, warranties need to be enforced if they are to be credible and such enforcement often depends on the existence of an independent legal system. Likewise, information regarding the reputation of a producer is more likely to be trusted when an independent agent (rather than, say, the dealer) is responsible for disseminating information about the performance of previous car sales.

The idea that repetition may help in these circumstances has been at the heart of some influential neo-classical analysis regarding the scope of the firm (here the firm is in effect a non-market institution which coordinates economic activity between agents). Williamson (1975) is concerned with explaining why agents become organized into firms rather than just exchanging goods and services through markets. In short, why do firms, as such, exist? Williamson suggests that all transactions involve some kinds of costs and the choice between organizing a transaction through the market or bringing it within a firm depends on which has the lower transaction costs. In particular, he argues that when a transaction involves one party making an investment in a specific asset (that is, an asset which has no value outside the relationship), then there is scope for opportunism because once the agent makes the investment, the other party has no incentive to pay the agent anything extra because the other party knows that the investing agent cannot use the asset in any other context. In such circumstances, it may be very difficult to write a market contract which

ensures that the agent is rewarded for making the investment in the specific asset, particularly when there is uncertainty regarding all possible future events which will impinge on the productivity of the asset. In contrast, Williamson suggests that organizing the transaction through a firm avoids the opportunism because the fates of both parties are now tied together. In addition, organization via the firm is liable to be less costly than relying on the market whenever the transaction is frequently repeated (so that the costs of setting up the firm are spread across a large number of transactions). Thus, the organization of transactions through firms is more likely than through markets when specific assets are necessary for a transaction that is frequently repeated.

Conclusion

The neo-classical interest in non-market institutions does not simply arise in connection with the type of market failure discussed in the previous section. The distinctive neo-classical approach to market interactions has for some time been applied to other types of interaction and institutions, like the family and government. Thus, the public choice and Chicago schools have given us the so-called 'economic' approach to government, to bureaucracy, to marriage, to divorce and so on. As a result, the neo-classical economic approach has the pretension to understand most of social life and not just behaviour in markets. The key to understanding all action is simply to appreciate people's objectives and incentives. This is a significant, if controversial, claim. Interestingly, however, much of the analysis of these other institutions has highlighted their propensity, like that of markets, towards failure (for instance, the public choice analysis of government failure). Thus, if one message of neo-classical economics is that most institutions are prone to fail, then (whatever its other merits) it has probably done little to dispel Carlyle's charge that economics is the 'dismal science'.

See also:

imperfect competition; individualism, methodological; institutionalism; labour theory of value; laissez-faire; liberalism; markets as institutions; Marxian economics; prisoners' dilemma; Sraffian economics

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SHAUN P. HARGREAVES HEAP

neo-classical economics, critique of

NEO-CLASSICAL ECONOMICS has attracted the usual share of critics for an orthodoxy. They come from far and wide: from INSTITUTIONALISM, KEYNESIAN ECONOMICS, the AUSTRIAN SCHOOL, MARXIAN ECONOMICS and so on. The charges are similarly various and they are not

always shared by all the critics. Nevertheless, two complaints stand out. One concerns the instrumental model of action employed in neo-classical theory and the other relates to the fixation on equilibrium states. Put bluntly, it is not obvious that the model of individuals calculating the action that best satisfies their preferences adequately explains behaviour in many circumstances; when it does, it begs a question concerning the origin of preferences and the institutional context for actions. Equally, it is not clear that an economy is ever in equilibrium and, even when an economy is tending towards an equilibrium, equilibrium analysis is only going to be satisfactory on its own when there is a unique equilibrium. In cases of multiple equilibria, one still needs a theory of equilibrium selection and this seems likely to involve an understanding of disequilibrium behaviour. Of course, the two complaints are often linked, since it is the appeal to alternative models of action which might offer a way of understanding disequilibrium behaviour.

The instrumental model of action and its problems

The model of action in neo-classical economics is either explicitly or implicitly instrumental (that is, action is undertaken because it secures the agent's objectives). It is explicitly so when individuals are assumed to have preferences over outcomes which motivate them to act. In such cases, individuals are assumed to be able to compare all the possible outcomes, rank them in order of preference and choose the action from within the available set that secures the most preferred possible outcome. These preferences are often represented by a utility function. This is a device that assigns the highest number to the most preferred outcome, the next highest number to the next most preferred outcome and so on until the worst outcome gets the lowest number. Hence, nothing deeper should be read into the term 'utility' in these circumstances, as maximizing a utility function is just an alternative way of

describing people who act so as to best satisfy their preferences.

Rational action in neo-classical economics is also often associated with action that satisfies certain conditions, the so-called 'axioms' of RATIONAL CHOICE theory. In these circumstances, it is perhaps no longer obvious that neo-classical economics relies on the instrumental model. However, if one asks why an agent might want their actions to satisfy these axioms, the answer seems bound to turn on the idea that they have some ends which they would like to achieve through an appropriate choice of actions (that is, an instrumental sense of motivation). For example, one of the key axioms in this approach is transitivity. This requires that if some outcome A is preferred to B, and B is preferred to C, then A must be preferred to C. It is often justified because intransitive choice creates the possibility of being traded into poverty. To see this, suppose that there is intransitivity because C is actually preferred to A and suppose the person starts with B. Given these preferences, the person would pay to trade B for A (as A is preferred to B), would pay in turn to trade the A for C (as C is preferred to A) and would pay again to trade the C for B (as B is preferred to C). Thus the person could have traded in a complete circle back to holding B, paying for the privilege at each stage, and the cycle is ready to be repeated again and again until the person has no wealth. Why would it be irrational for a person to allow themselves to be traded into poverty in this way? The most obvious answer is that the person has preferences (or ends) they would like to see satisfied and a state of poverty undermines the capacity to satisfy those preferences.

One of the great virtues of the neo-classical approach is that it is rarely necessary to say anything further about the precise nature of people's preferences. People's preferences can be selfish, altruistic, cranky or whatever, all that matters is that they have an ordering over outcomes and act on it. This makes the model look promisingly general, because no constraint is placed on the character of a person's preferences. But is it general enough to cover

all types of action? There are several reasons for doubt.

First, several critics have doubted that individuals have the information about how actions translate into outcomes to enable calculation of the optimal action. If you want to get to the other side of the road as quickly as possible, then a moment's reflection suggests that you should take the shortest path by crossing the road at a right-angle. But many economic decisions are not like this. For example, the likely returns from an investment project will depend on many factors in both the near and distant future, because pieces of machinery frequently have useful lives of between twenty and fifty years. One can collect information that enables an assessment of the likelihood of some important factors, but some defy any kind of probabilistic assessment. For example, who would have thought that there was a remote possibility of the Berlin Wall collapsing even as much as a year before the famous events in 1989, or that Germany would reunify within a matter of months after that? These were dramatic events that affected the investment opportunities in Germany and elsewhere, and yet nobody can reasonably have been expected to have taken them into account much before November 1989. The problem is that the future is, in some respects, unfathomable and the unexpected does happen. In such circumstances, the idea of precise calculation of what to do for the best seems wide of the mark. Either individuals seem likely to rely more or less on rules of thumb in their decision-making when there is this kind of uncertainty (which is the view of behavioural economists like Simon) or on shared rules in the form of conventions (which is the view of many Keynesians). Alternatively, individuals who have the capacity for decision-making that is more creative than calculative will prosper (which is the view of the Austrian School when emphasizing the role of the entrepreneur).

It may be tempting to think that uncertainty really only creates problems for calculations when the decisions have consequences which stretch well into the future. But this is not always the case. Recall the introduction of

video cassette recorders. In the early days, people had to choose between two standards: Betamax and VHS. There were technical differences between the standards and individuals could collect information on this which would help in their decision, but the key piece of information concerned what everyone else was planning, because people suspected that one standard would come to dominate and the other would vanish. So the key to the decision was to anticipate the decisions of others (and so avoid being lumbered with a dinosaur). But how can you collect information on this when those other individuals are in the same position of wanting to know what others will do before they themselves decide? This is a coordination problem and can create problems for decision-making even when the consequences of the action are not long lived.

Second, there seem to be problems with the descriptive accuracy of the theory, even when there are no information problems. In laboratory experiments, where relatively simple and self-contained decisions can be studied and where the relevant information can be given to people making the decisions, it is often found that individuals either do not process the information properly or do not act on it in a consistent manner. For example, it is well known that people tend to value medical treatments differently depending on whether survival or mortality rates are used to express their relative successes (thus something that succeeds in 90 per cent of cases is often perceived as better than one which fails in 10 per cent).

Third, there are some doubts over whether all human projects can be accommodated within the preference-belief-action model. Consider being spontaneous. One cannot act spontaneously as a result of having the objective of being spontaneous because to have such an objective would be to undermine the project itself. There are, so to speak, certain things which cannot be willed. Likewise, consider the way that many actions have symbolic properties (see Douglas and Isherwood, 1978). For example, when a person buys a pair of Levi 501s rather than a plain pair of

blue denim trousers, it is often because wearing Levi 501s says something about the person that would not be achieved by a mere pair of blue denim trousers. Likewise, when a person forsakes (or takes) the larger of two pieces of cake, the action says something about the person and often forms part of what is in effect a non-verbal conversation with others over what is valuable and worthy. Of course, conversations often achieve things for individuals and so can be construed instrumentally, but they are also sometimes their own end (see Habermas, 1985–6, on communicative action). The value is in taking part and it is not obvious that participation in this sense can be fully understood instrumentally. For instance, suppose the symbolic content of taking the smaller piece of cake is construed as instrumental because the action reflects well on the individual and so satisfies their preference for self-respect. At the very least, this reduction of self-respect to a type of preference is liable to miss the important feature of such conversations: that ideas about what is worthy shift and, with them, so do actions. So a concern for self-respect is not going to generate a constant set of preferences over actions.

This leads directly to the next doubt. Where do preferences come from? Neo-classical economics takes them as given, but surely we are not born with them and so a complete account of action should include a model of preference formation. This observation can lead in a variety of directions from a psychological/behavioural approach to institutionalism and Marxian economics. In the case of the last two, the doubt is not just over the origin of preferences, but also over the origin of the other givens of the neo-classical model, the person's endowments and the other institutional constraints on action. It seems that the these constraints (the distribution of property rights, the laws of the land, the norms of the community and so on) are often more powerful determinants of action than the individual's instrumental calculations that take place within them. Again, the complete account of action would seem in these circumstances to depend on an explanation of the origin of these

institutions. The ambitious reply to such worries comes from the Rational Choice School, which tries to use the instrumental model to explain the origin of such institutions. The hope is to explain the origin of these institutions as the deposits from previous interactions between individuals in a 'state of nature'. However, these attempts often fail because many interactions in such states generate multiple equilibria and so the worry about the origin of institutions is merely displaced to a concern with the explanation of equilibrium selection (see below).

The problems with equilibrium analysis

The Austrian School's complaint with respect to equilibrium analysis is that it misses what is essential about markets and private property rights. People could never have the information that would enable them to undertake equilibrium actions. The economy is, so to speak, permanently shrouded in fog and agents only ever get glimpses of where they might be going and what options are available. What can be said about the combinations of markets and private property (and this is the Austrian message) is that these institutions provide agents with every incentive to use their patchy information to make mutually beneficial trades. This is the great virtue of markets: they make the best of a world which might otherwise hopelessly underperform in the fog.

Of course, this criticism of equilibrium analysis need not be decisive and one can see how equilibrium analysis might still be defended as a useful approximation. The equilibrium, after all, is what the economy is groping towards (courtesy of the activities of the entrepreneurs of the Austrian School) and, even if it is never quite reached, the analysis of it will not be seriously misleading. This defence is not implausible when there is a unique equilibrium, because the character of the disequilibrium activities of entrepreneurs in such circumstances will not affect where the economy is going. However, matters are rather different where the entrepreneurial eye for the main chance also leads to innovations which

actually alter the equilibrium towards which the economy is moving, or where there are multiple equilibria and the economy exhibits path dependence. In these circumstances, it is crucial to understand the disequilibrium behaviour of agents because it actually affects the equilibrium towards which the economy is moving. Equilibrium analysis is not enough.

It is one of the insights of GAME THEORY that there are a large number of interactions between instrumentally rational agents that generate multiple equilibria (for example, coordination, chicken and battle-of-the-sexes games), so this deficiency in an analysis which relies exclusively on equilibrium states seems potentially significant. The same conclusion comes from the attempt to circumvent the information problem referred to above by appealing to the concept of RATIONAL EXPECTATIONS. When there are multiple rational expectations equilibria, something more than an assumption of rational expectations is required to explain expectation-formation: namely, an account of equilibrium selection. By definition, this must involve some change in the model of individual action, because the application of that model has generated the problem of multiple equilibria. Thus the worry about equilibrium analysis is itself connected to concerns over the instrumental model of action.

Conclusion

There appear to be worrying gaps in the neo-classical explanation of the economy that have their origins in the exclusive reliance on the instrumental model of action. This is an explanatory weakness that also has consequences for the normative analysis of neo-classical economics. The normative analysis typically judges outcomes according to how well they satisfy agents' preferences and so, in so far as people are quite sensibly motivated in other ways, these judgements are bound, at best, also to be flawed because they are partial.

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SHAUN P. HARGREAVES HEAP

neo-colonialism

'Neo-colonialism' is a new imperialist system whereby the LESS-DEVELOPED COUNTRIES (LDCs) are subjected to indirect DEPENDENCE, subordination and EXPLOITATION. This is practised at a time when direct domination has been eliminated and the balance of world power has gone considerably over towards democracy and the WELFARE STATE. Neo-colonialists want to hold sway over the markets and resources of the LDCs, and thereby try to gain certain selfish advantages. The developed capitalist countries try to retain political influence over the LDCs and to ensure the exploitation of their productive resources. Neo-colonialism is a manifestation of world MONOPOLY CAPITALISM.

Nature and objectives

Neo-colonialism has many facets, including multitudes of political, economic, social, ideological and other ways and means of keeping

the LDCs within the ambit of world capitalism. It is dynamic in its approach and action, and is totally against the LDCs following an independent path of development. The ideological neo-colonialism invents new concepts and theories, showing the importance of modernization, reform and new political leadership in the LDCs. It is observed by the neo-colonialists that the LDCs are underdeveloped because they do not follow the capitalist path of development. Some neo-colonialists propagate the idea that neither CAPITALISM nor COMMUNISM can achieve anything remarkable, but a welfare state can. Therefore such a state is considered essential and they advocate certain so-called 'reforms' within the bourgeois framework. Bourgeois economists support the view that there is no incompatibility between economic development and colonialism: for example, P.T. Bauer tries to demonstrate that the colonial system and economic progress are quite compatible and rational (Bauer, 1971: 148). To support his thesis, he cites the experiences of Australia, Canada, New Zealand and the United States.

An important objective of neo-colonialism is to capture the state machinery of the young independent states and introduce through it the growth of the private sector. It popularizes the idea of partnership in the process of economic development only to exploit the partner at a later stage. The methods of neo-colonialist exploitation are various: AID, trade, business through MULTINATIONAL CORPORATIONS (MNCs), transfer of technology, the drawing away of physical and human capitals, intervention in the policies of education, research and development, and so on. The basic desideratum of neo-colonialism is to sustain a method of 'dependence type' development which can influence the domestic policy of a country and also the formation of international relationships. The internal development policy is influenced by the neo-colonialist power through various types of overt and covert practices. Neo-colonialists consider it their main task to preserve the system of unequal economic relations between the imperialist powers and the newly independent countries

as the basis of economic exploitation of these countries by IMPERIALISM.

Neo-colonialism is essentially the extension and the last stage of imperialism (Ghosh, 1985: 12). According to laws of capitalist development, competition is gradually wiped out and MONOPOLIES develop in the domestic economy. The monopoly is also exported to other countries as a vent for the utilization of surplus capital. Thus, the generation of more and more surplus capital and the creation of more and more monopoly power are the bases of capitalist development. As colonialism died it gave birth to neo-colonialism in order to maintain economic exploitation and political influence. The taste for enjoyment of power dies hard, becoming second nature, and cannot be easily given up by the imperialists, even if direct political domination is impossible. The policy of neo-colonialism is one of the manifestations of the so-called 'global strategy' of imperialism.

The concept of neo-colonialism admits of various interpretations and connotations. Neo-colonialism is a complex and comprehensive phenomenon, embodying subtle methods operating in economic, religious, ideological and cultural spheres. On the economic front, it resorts to deceptive formulas for domination; it also establishes military bases, creates organs of repression, signs secret military pacts and so on. It may also encourage and carry out coups d'état and political assassinations to safeguard and sustain puppet governments. Bourgeois scientists justify everything they want through theorizing, substantiated by the shallow types of empiricism. In the USSR, the term 'neo-colonialism' was used to express domination and exploitation of the LDCs by the capitalist countries. It also may mean consolidation of capitalism and putting obstacles in the path of the national liberation movements through different manoeuvrings and manipulations. Neo-colonialism attempts to make independent countries follow the capitalist system and, at the same time, preserves or even expands the influence and power of foreign monopolies in the LDCs.

Method of operation

Neo-colonialists introduce imperialist colonial policy through a series of carefully disguised military, political, economic, financial, commercial and ideological methods and manoeuvres. Dependent development is the *sine qua non* of neo-colonialism. The imperialists are interested in the retention of productive process within a capitalist framework (Barrat Brown, 1974: 284). The developed countries (DCs) particularly want to see that the LDCs do not make any profound socioeconomic change.

THE NEW INTERNATIONAL DIVISION OF LABOUR (NIDL) is a policy of neo-colonialism which aims at binding the LDCs in a process of dependent development. It wants the LDCs to start only light industries and to specialize in agriculture. Capital-intensive products can be purchased from the DCs. The attempt to secure this international division of labour, by which the DCs produce industrial goods and the LDCs produce agricultural goods, is sustained by any means available. This objective is partly achieved by the MNCs. The MNCs and foreign companies compete with the local producers and mainly produce goods for conspicuous consumption. Owing to abundant supply of cheap labour and land, the MNCs can appropriate more SURPLUS VALUE by keeping the prices higher with the help of increased mark-up. All this results in exploitation, spread of unnecessary capital-intensive production in a labour-surplus economy, increased unemployment and limits on the size of the market. Thus, the neo-colonialist method contributes to an undesirable production structure in LDCs. THE MULTINATIONAL CORPORATIONS (MNCs) use the most flexible method of operation and penetration. They always try to broaden their social foundation by bringing over to their side the support of the local bourgeoisie, bureaucrats and a part of the so-called 'middle strata' of the population. They give opportunities to influential businessmen to get rich quick. The MNCs are the agents of the neo-colonialists. They are used in the following ways: (1) as vehicles for the export of capital to

the LDCs, (2) as vehicles of unequal TERMS OF TRADE, (3) for access to the markets of both the DCs and the LDCs, (4) for aid and INVESTMENT, and (5) for the sale of technology.

Neo-colonialism stimulates private enterprises, creates the most favourable conditions for foreign capital and cooperates between local and foreign industrialists. The neo-colonialists want to give more and more aid to promote their own interests, (1) making the LDCs dependent and (2) enabling the LDCs to purchase more from the DCs. However, neo-colonialism has turned away from aid as the only weapon of intensification of foreign trade and exchange, and of expansion of the export of private capital. Neo-colonialists want to modernize the international capitalist division of labour and use the objective laws in their own interests. The capital is exported through the creation of international private firms, consortia and corporations designed to secure favourable terms and conditions for investment for the private investors from the DCs. The investment, needless to say, is for the maximization of profit and not for the welfare of the native masses. Imperialism cannot do without certain products and raw materials of the LDCs, nor can it do without selling its own products to the LDCs. Hence, trade occupies a very strategic position. It may be noted that the Third World countries absorb a quarter of the total exports of DCs. Investment, of course, is made in secondary industries and such investment is determined solely by market considerations. In the realm of trade, the basis of exchange always remains unequal.

The industrialized countries are today involved in a technical revolution which has made it impossible to progress economically and socially within the narrow national framework. Technology has been exported to the LDCs; however, technical neo-colonialism is now a growing menace for the LDCs. The DCs cleverly pass on out-of-date technology, which is mostly inappropriate to the needs of the destination country, to the LDCs at a high price, and want to retain the secrets of production and control over the use of the technology.

Neo-colonialists try to capture the state machinery and influence the leaders, officials and bourgeoisie, for a state can even rise above the dominant class in a developing society. They often employ influential people to get things done. Another recent objective of neo-colonialism is to form a capitalist social structure. The neo-colonialists have now realized that, if the LDCs remain underdeveloped, they cannot be profitably integrated into the world's capitalist economy. In fact, a prosperous world capitalist economy is impossible without Africa, Asia and Latin America. This is perhaps the reason why the neo-colonialists are interested to some degree in the so-called 'development' of these poor countries: many socioeconomic and political reforms are being carried out there, and some concessions are given to the loyal countries, labourers and bourgeoisie. But, basically, the idea is to exploit the LDCs from every possible angle, using military blockades and organizations like the NORTH ATLANTIC TREATY ORGANIZATION (NATO), South-East Asian Treaty Organization (SEATO), Central Treaty Organization (CENTO), Organization of African States (OAS) and similar other pacts to attain the objective. Since World War II, militarism in the capitalist world has been growing on an unprecedented scale. While, before the war, military production was largely a separate and distinct process from civilian production, since the war it has been integrated into the dominant industrial sector.

Another aspect of modern neo-colonialism is the spread of monetary and financial powers over the LDCs. The so-called 'international organizations' – for example, the WORLD BANK, the INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA), the INTERNATIONAL MONETARY FUND (IMF) and so on -- are only the other side of the coin of military organizations. In the monetary and financial systems of the world, the LDCs have no access to decision-making because they are excluded from the management role. The institutions established under the BRETTON WOODS SYSTEM should be replaced, as they have outlived their utility, particularly for the developing

countries. While some immediate measures might help the Third World to overcome its BALANCE OF PAYMENTS difficulties, a lasting solution to the problems could not be brought about without restructuring the global financial and trading systems. There are interference by and pressure from international financial institutions on the developing countries to effect changes in policies. The GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) has administered trade discipline in favour of the DCs and acquiesced in many flagrant violations by them to deprive the Third World nations of their due share of their own markets.

The central mechanism of neo-colonialism can best be understood through the theory of international dualism, which unfortunately is not yet developed on any sophisticated analytical plane. Resources are drawn away by DCs from the LDCs for investment and reinvestment in order to accumulate more and more surplus. This is the basic *modus operandi* of the process of capitalist development. Since a large chunk of the resources of the LDCs is siphoned off, these countries *ipso facto* become poorer, while the DCs become correspondingly richer and richer. In this system, the LDCs cannot completely die out because there is a feeble reverse flow of resources from the DCs to the LDCs, simply to sustain the LDCs so that at a later stage they may again be subjected to exploitation.

The approach of the neo-colonialists is very subtle, sober and sometimes sophisticated. Jawaharlal Nehru once observed that economic imperialism of the United States does not want to annex any country, but it exploits nations from without (Nehru, 1947: 478-9). Neo-colonialists divide and rule from behind the scenes; they create and sustain 'cold' and 'hot' wars between nations, and such unsettled areas then provide the happy hunting ground for neo-colonialism.

See also:

dependency theory; immiserising growth; uneven development

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B.N. GHOSH

neo-functionalism

Neo-functionalism is concerned with explaining how and why nation-states cease to be wholly sovereign: how and why they voluntarily mingle, merge and mix with their neighbours, so as to lose the factual attributes of sovereignty while acquiring new techniques for resolving conflicts between themselves. More precisely, neo-functionalism describes a process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities towards a new and larger centre, whose institutions possess or demand jurisdiction over the pre-existing national states.

In neo-functionalism, the primary players in the INTEGRATION process are above and below the nation-state. Actors below the state include interest groups and political parties; above the state are supranational regional institutions. These supranational institutions promote integration, foster the development of interest groups, and cultivate close ties with them and with fellow-technocrats in the national civil services.

Three related concepts lie at the core of the dynamics of integration: functional spill-over, political spill-over and upgrading of common interest. Functional spill-over is based on the assumption that the different sectors of a modern economy are highly interdependent and that any integrative action in one sector creates a situation in which the original goal can be assured only by taking further actions in related sectors, which in turn create further conditions and a need for more action, and so forth. Political spill-over describes the process of adaptive behaviour – that is, the incremental shifting of expectations, the changing of values, and the coalescing at the supranational level of national interest groups and political parties in response to sectoral integration. Finally, upgrading of common interest occurs when the member-states experience significant difficulties in arriving at a common stand to safeguard other aspects of INTERDEPENDENCE between them. One way of overcoming such a deadlock is by swapping concessions in related fields. In practice, the upgrading of the parties' common interests relies on the services of an institutionalized autonomous mediator. This institutionalized swapping mechanism induces participants to refrain from vetoing proposals and invites them to seek compromises, which in turn bolster the power-base of the central institutions.

See also:

economic integration

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WALTER MATTLI

neo-Gramscianism

ROBERT COX pioneered the neo-Gramscian approach to international political economy (IPE) in the early 1980s. The outline of neo-Gramscianism is mainly based on his two seminal articles (Cox, 1981; 1983). Cox rejects structuralist approaches to international relations (IR) (such as NEO-REALISM) and structural Marxist approaches (such as, for example, those of Althusser and Poulantzas) which exhibit a similar ahistorical, essentialist epistemology. Instead, Cox attempts to offer a dialectic, non-deterministic Marxist approach to IPE by transferring concepts from the fragmented work of ANTONIO GRAMSCI on the Italian political and economic system of the 1920s and 1930s to the international level. In other words, neo-Gramscianism is a historicist Marxist approach, which rejects the notion of objective laws of history and focuses on class struggle as a heuristic model for understanding structural change. Collective human activity has formed structures over time which, in turn, shape collective action and thinking. Structural change is, then, the result of a dialectic interplay between structure and agency.

Cox distinguishes between problem-solving and CRITICAL THEORY. While the former accepts the social and power structures and institutions as it finds them and deals with problems within this framework, critical theory calls them into question, investigates their origins and assesses whether they are in the process of change. In short, critical theory is a theory of history in that it is concerned with understanding the process of change affecting the very structures that problem-solving theory takes for granted. Human institutions (such as the state and human nature) are, consequently, not understood as fixed. Rather, they are perceived as a continuing creation of new forms. Critical theory, moreover, does not distinguish between beliefs and ideologies on one hand and objective facts on the other. Instead, it is realized that ideas in the form of inter-subjective meanings are as constitutive of social reality as material characteristics and

that, therefore, every theory, itself derived from a particular place in time and space, incorporates a particular perspective.

Neo-Gramscianism, developed on a critical basis, views every historical structure as the expression of a particular configuration of forces establishing the framework for action in a given period. There are three different types of forces: material capabilities, which are productive and destructive potentials; ideas, which are either inter-subjective meanings or collective images of social order, and institutions, which are a means of stabilizing and perpetuating a particular order by promoting those ideas which are consistent with that order. Having developed a life of their own, institutions may even become a battleground of rival collective images. These three types of forces interact with each other on three different interconnected levels of activity: the level of the mode of social relations of production (that is, the material and organizational structure of production where the social forces as main collective actors can be identified), the level of forms of state as derived from a study of state/society complexes, and the level of world order.

Neo-Gramscianism pursues a dialectic method of enquiry. It acknowledges the potential for alternative forms of development resulting from the confrontation of opposed social forces in concrete historical situations. The notion of historically inevitable development is rejected and the focus of investigation is directed towards social forces in a particular historical period in order to identify possible alternatives and future developments. The sphere of production is, thereby, reintroduced into the analysis as the material basis of all forms of existence. The relations which organize material production are considered to be crucial for the wider institutional reproduction of social orders on both a national and an international level. Finally, the state-centric perspective of approaches such as neo-realism is rejected and Cox replaces it with an analysis of the relation between civil society and the state. Hence, different forms of state are distinguished according to the configuration

of social forces at the state level. This implies that states cannot be treated as unitary actors, but as structures within and through which social forces operate. In a further step, the international system is also perceived as being actively reproduced as a set of social relationships and the world order is regarded as the geopolitical expression of a wider social totality. The artificial separation of domestic and international spheres is avoided through this.

The centrepiece of the approach is Gramsci's concept of 'historic bloc', which is the term applied to a particular configuration of social classes and ideology. It consists of classes or fractions of classes, which form an alliance in order to establish a particular order at the three levels of activity. Rule can be called 'hegemonic', if it is based on a coherent fit between a particular configuration of material power, a prevalent collective image of order at the three levels of activity, and institutions which administer this order. A hegemony of this type is predominantly characterized by consensus, not by coercive force (see *HEGEMONY, BLOC; HEGEMONY, GRAMSCIAN*). 'Organic intellectuals' (being the true representatives of a particular social group) play a crucial role in obtaining hegemony. It is their task to develop a 'hegemonic project' which is able to attract the support of other social forces outside their social group. 'Organic ideas' (the content of the 'hegemonic project') stem from the economic sphere. They must, however, also go beyond economics (the structure) into the political and social sphere (the superstructure), incorporating issues such as social reform or moral regeneration, to result in a stable hegemonic political system. The notions of 'organic ideas' and the 'organic intellectual' make a dialectic analysis between structure and superstructure possible.

Neo-Gramscianism and globalization

Globalization from a neo-Gramscian perspective is characterized by the transnationalization of production (that is, the organization of production on a transnational scale) and the transnationalization of finance (that is, the

emergence of an integrated financial world market). These processes have established a global economy above the state system, limiting national sovereignty and policy autonomy. This has been accompanied by a change in the dominant economic paradigm from *KEYNESIAN ECONOMICS* to *NEO-LIBERALISM*.

A neo-Gramscian analysis of globalization starts by investigating the changes in the sphere of production since the early 1970s. The transnationalization of production and finance, it is argued, has engendered new transnational social forces, which may become the basis of a new, transnational historic bloc. The management of *MULTINATIONAL CORPORATIONS* (MNCs) and international financial institutes (that is, transnational capital) are members of this bloc. Furthermore, the employees of these internationally oriented companies are also likely members: an alliance, which can be sealed via enterprise corporatism. As for the material capabilities, the transnational historic bloc may be based on an inter-state coalition of *ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT* (OECD) states centred around the *GROUP OF 7* (G-7) and some of the more industrialized developing countries (such as Brazil). Neo-liberalism supporting international free trade, liberalization and deregulation is the ideological content of this order, further sustained by international institutions such as the *INTERNATIONAL MONETARY FUND* (IMF) and the *WORLD BANK*. Moreover, Cox speaks about the internationalization of the state, which has brought to the foreground in national politics those national institutions that are linked to the global economy (such as central banks, finance ministries and prime ministers' offices). They are an active part of the transnational historic bloc, carrying out deregulation and liberalization of their national economies.

Nevertheless, there are opposing social forces pointing to alternative forms of development – to other possible hegemonic orders within globalization. One alternative possibility is a neo-mercantilist class alliance consisting of nationally oriented capital, dependent on protectionism and state subsidies, their

employees and those ministries which are concerned with exclusively national problems such as unemployment (for example, labour ministries). 'Organic ideas', part of this hegemonic project, are concepts like national security, territorial sovereignty and a mercantilist stress on strategic industries. A further possibility is the rise of a counter-hegemonic bloc, based on developing countries with the target of independent development, and incorporating political, feminist and environmental movements in the industrialized countries. So far, the transnational historic bloc seems to be in the strongest position, but the final outcome is the result of an open-ended class struggle.

See also:

hegemony, bloc

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ANDREAS BIELER

neo-liberalism

As it has evolved over time, the term 'neo-liberalism' is usually used by economists to refer to the economic policies pioneered by Chile in the 1970s. Subsequently these reforms spread through most of Latin America in the 1980s and to other parts of the developing world in the late 1980s and early 1990s. In this sense, neo-liberalism emphasizes a policy mix stressing a greater role for the market in the allocation of resources, a much reduced role for the state and increasing integration in the world economy. Unfortunately, in Latin America and many other nations, neo-liberalism has come to represent the 'evil of all evils' and to be held responsible for all problems by people who have no clear notion or definition of what neo-liberalism really is.

The literature reflects these two differing views towards the neo-liberal reforms. One side considers the structural reforms inspired by neo-liberalism to be the quintessence of good economic policy, while the other considers this model a disaster, involving excessively high costs, especially measured in terms of the suffering imposed on groups unable to protect themselves from market forces.

The intellectual foundations of modern neo-liberalism stem largely from the writings during the 1950s and 1960s of FRIEDRICH VON HAYEK and MILTON FRIEDMAN. In large part, Hayek and Friedman were responding to the emergence (and subsequent predominance) of Keynesianism in Western capitalist societies and to the socialism that evolved in the former Soviet Union, China and many other nations following World War II.

In the eyes of the neo-liberals, the triumph of democracy and markets over authoritarianism and statist economies was combined with efforts to promote open economies and open

policies stressing the necessity of thorough-going economic reforms supporting export-led industrialization policies.

For development economists, the rise of the East Asian economies – vindicating the liberal prescriptions of market-oriented policies and participation in the world economy – made obsolete policies drawn from state-interventionist theories and protectionism. New growth trajectories stressing the importance of export-led development became widely accepted as an integral part of the neo-liberal ideas inspiring economic and political changes in the world. Moreover, the downfall of communism in Eastern Europe and the collapse of the apartheid regime in South Africa can be depicted as the supreme examples of ill-fated attempts to sustain economic growth within a closed economy.

In the Latin American case, the initiation of this new development model was due to a combination of various factors: first, the external DEBT CRISIS gave rise to heavy macro-economic imbalances and the subsequent stagnation that was characteristic of the 1980s; second, although the progress which accompanied the IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI) strategy was on a scale without precedent in the region, in the mid-1970s this model began to give sharply decreasing yields which were reflected in the stagnation of total factor productivity; third, theoretical and empirical criticisms of state interventionism began to be levelled in the North and were taken up by Latin American neo-liberal circles, which attacked such interventionism not only because of its alleged inefficiency, but also for trying to create a modern WELFARE STATE on the basis of a weak economic structure.

The neo-liberal core is based on three important concepts: (1) imperfect information, (2) individual freedom and (3) the market.

1 *Imperfect information.* Neo-liberals contend that because individuals, in general, and society as a whole have imperfect information about past and present developments and events, any strategy attempting to plan

or make policies is irrational and doomed to fail (Hayek). However, neo-liberalism goes further, pointing out that any attempt to plan or construct a society that attempts to go beyond these natural restrictions is dangerous for the existing social order.

- 2 *Individual freedom.* Neo-liberalism is based on the freedom of individuals to seek to maximize their preferences and on the primacy of private ownership of property. This apparently natural behaviour is particularly important from an economic viewpoint because it leads to political freedom. Thus, individual economic freedom is the basis for any civilized society and is a direct response to totalitarianism or to any form of economic planning.
- 3 *The market.* The market is the principal economic and social institution within which individuals adjust their preferences according to price signals, in spite of restrictions on the available information. Hayek and Friedman are aware of the market's limitations, since perfect competition, individual freedom and private ownership, as well as instantaneous price adjustments, depend on perfect information. The concept of 'market' thus becomes utopic and yet is dogmatically defended by the neo-liberal against any form of planning or state intervention.

Baer and Maloney (1997) note that while numerous economic policies have been encompassed under the rubric of neo-liberalism, in actual practice it is often difficult to separate macro-economic adjustment policies from liberalization measures. With this caveat in mind, they list the main components of neo-liberalism as: (1) fiscal adjustment, (2) privatization, (3) decontrolling and/or adjusting prices, (4) decontrol of the financial sector, (5) trade liberalization, (6) incentives to foreign investments, (7) social security reform and (8) labour market reform.

- 1 *Fiscal adjustment.* In the Latin American context, this was achieved largely through reductions in subsidies and tax reforms.
- 2 *Privatization.* Since the world depression of

the 1930s, Latin American governments had increased their presence in their economies through the founding of state enterprises in heavy industries, through the expansion of petroleum and other mineral resources, and in public utilities, banking and even some consumer goods industries. Although this presence might have contributed to the industrialization and growth of some of these economies in the region, by the 1970s and 1980s many state enterprises had become loss-making operations due largely to inefficiency. Beginning at the end of the 1980s, most of the region's governments were convinced or persuaded by their creditors that, in order to achieve a fiscal adjustment and to improve the efficiency of the economy, a substantial portion of public sector enterprises should be privatized. With neo-liberal reforms, privatization is usually accompanied by an increased emphasis on private property rights.

3 *Decontrolling and/or adjusting prices.* For many decades, Latin American governments controlled many types of prices – such as public utilities, basic food products and some industrial products – as instruments of income distribution or as a way to decrease inflationary pressures. The net effect of these controls was to distort the allocation of resources, turn many firms in the affected sectors into loss-makers requiring government subsidies and, in some sectors, to discourage investment. The neo-liberal agenda was to either free prices totally or to readjust prices of the controlled sectors so as to provide firms with a positive rate of return. In a similar spirit, the vast overvaluations of the exchange rate were to be avoided in favour of rates that would encourage integration with the rest of the world.

4 *Decontrol of the financial sector.* Controlled interest rates, often negative in real terms, allocative quotas for bank loans and forced bank holdings of government debt discouraged savings and distorted the allocation of scarce capital resources. Ending 'financial repression' implied greater market allocation of investment resources and often the

liberalization of controls on external capital flows.

5 *Trade liberalization.* Most Latin American countries had retained the high levels of protection which were instituted as part of the promotion of their ISI programmes of the 1950s and 1960s. In addition to the standard inefficiencies arising from tariffs and quotas, these regimes pushed countries away from developing in line with innate COMPARATIVE ADVANTAGE, shielded industries from healthy external competitive forces and gave rise to RENT-SEEKING opportunities.

6 *Incentives to foreign investments.* After the 1982 Mexican debt default (see MEXICAN PESO CRISIS), most countries of the region experienced a drastic decline in private investment, a shortage of fiscal resources for the expansion of state enterprises and the increased obsolescence of their industrial technology. Following Chile's lead, many opened their entire economy to foreign investment, including such formerly closed sectors as telecommunications, petroleum, power generation and distribution, and so on, frequently through DEBT-EQUITY SWAPS.

7 *Social security reform.* The traditional pay-as-you-go social security systems in Latin America were generally vastly underfunded and constituted a major, although hidden, component of government debt. Again, in 1980 Chile led the way to establishing private, competitive pension funds where workers held individualized accounts that reflected their accumulated contributions.

8 *Labour market reform.* The labour-protection system embodied in many Latin American constitutions is thought to have led to excessively rigid labour markets that were ill-adapted to competition in a competitive, global economy. Under neo-liberal reforms, Chile's military government disbanded unions and repealed minimum-wage laws.

Neo-liberals in Latin America are firmly convinced that, with few exceptions, the set of measures referred to above is both a necessary

and sufficient condition for growth and also for equity. They maintain that if this model fails to give the desired results, this is due to rigidities derived from the interventions of economic policy and institutions.

In contrast, neo-structuralists and other critics of the neo-liberal agenda attribute poor economic performance to flaws in key markets (that is, rigidities, segmentation and gaps in those same factor markets), so that they question whether that set of measures *will* automatically result in growth, let alone equity. They therefore call for state intervention to correct these critical flaws and claim that the notable success of the NEWLY INDUSTRIALIZED COUNTRIES (NICs) in Asia, in terms of both growth and equity, is due precisely to such interventions.

To critics, the neo-liberal reforms have simply resulted in one of the following: (1) the rationalization of economic production and distribution on a global scale along the lines of comparative advantage and vast corporate ECONOMIES OF SCALE; (2) the maximization of the rate of return (that is, profit) on invested capital for transnational banks and corporations and tier stockholders. The costs of these programmes are reflected in one or (usually) more of the following:

- 1 increased concentration of wealth in the hands of the very rich;
- 2 increased unemployment and underemployment;
- 3 wages that remain low for those who still have jobs, even as workforce productivity increases;
- 4 decreased power of trade unions under the pressure of economic globalization;
- 5 increased crime as more people become economically marginalized;
- 6 increased numbers of police and prisons to combat the increase in crime;
- 7 an erosion of civil liberties;
- 8 increased homelessness and street begging;
- 9 an erosion of civil liberties;
- 10 rural depopulation as small farmers are put out of business by corporate agribusiness which, with free trade, can take full advantage of its economies of scale;

- 11 armed resistance by traditional cultures put under economic siege;
- 12 increased immigration to more economically developed countries by those who no longer have land to work and/or cannot find work in the cities;
- 13 an increasingly irrelevant political system that is unable and/or unwilling to start a genuine, democratic debate because it is controlled by interlocking corporate interests that have the most to gain from the status quo
- 14 an alarming decrease in social solidarity.

Ramos (1997) suggests that another way of looking at the neo-liberal reforms is to note that, although in general terms the reforms make sense in the long run, there have been serious technical errors in their application, because the local neo-liberals idealize the market and seem to attribute to it the capacity to adjust rapidly, automatically and effectively to any kind of disturbance or policy change. Yet another approach is taken by advocates who, while recognizing there have been costs due to the neo-liberal approach in terms of distribution, contend that (based on experience) most of the reforms could be effected without regressive costs if applied judiciously and accompanied by additional measures to avoid or relieve distributive problems.

More pragmatically, Taylor (1992) finds that there are examples of success and failures of both neo-liberal and heterodox political initiatives. The problem is how to invent and sequence policy changes that will be effective in each economy's historical and institutional contest.

See also:

deregulation; liberalization; neo-classical economics

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ROBERT LOONEY

neo-Malthusianism

The concept of 'neo-Malthusianism' is an extension of the writings on population by THOMAS MALTHUS (1766–1834), who argued that uncurbed POPULATION GROWTH would outstrip the world's capacity for food production on the basis of population increasing in a geometrical ratio while subsistence increases only in an arithmetical ratio.

Malthus' ideas became globally known through the influence of the British Empire. It was combined with Charles Darwin's views of the survival of the fittest to form neo-Malthusianism. The extrapolation of Darwin's survival of the fittest to human societies permitted a novel twist in Malthusian thought – namely, that overpopulation was a vehicle of progress.

This neo-Malthusianism had an empirical application in the British imperial famine policy in India: British policy-makers felt that the famine must be due to insufficient agricultural production and that the population surplus should be removed by emigration or death. In the 1960s and 1970s a new wave of neo-Malthusianism was triggered by the publication of Paul Ehrlich's *The Population Bomb*, which argued that the population in developing countries needed to be curbed in the interest of the planet as a whole.

It is generally accepted that Malthus was mistaken in his views of human reproduction, as his simple model overlooked cultural fac-

tors. In addition, he miscalculated the human ability to increase agricultural yields through better TECHNOLOGY. For example, according to the FOOD AND AGRICULTURE ORGANIZATION (FAO) of the United Nations (UN), less than half of the world's potential arable land was under cultivation in the mid-1980s and the land in agricultural use could produce food for the whole world population even without the use of intensive farming methods.

However, the issue of population growth remains highly contested, as demonstrated by the recent UN Population Summit. A key feature of all neo-Malthusian thought is its conceptualization of population growth as an independent variable influencing society and the environment. However, a historical approach to global population growth reveals that demographic changes occur as the result of major changes in social organization. The industrial and scientific revolutions have resulted in dramatically increased population growth since 1750. These developments were, however, matched by steadily increasing agricultural yields.

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GABRIELA KÜTTING

neo-Marxism

The term 'neo-Marxism' refers to a body of theory that has in common the use of parts of the conceptual apparatus of theories drawn from the work of KARL MARX. 'Neo-Marxism' is, however, both a very broad term and a contentious one. It is broad because it can be used to categorize a range of theorists: from those who wish to adopt explicitly some of the theoretical apparatus provided by Marx, through to those whose main connection with Marx might be a normative or moral concern for those excluded from the benefits of global CAPITALISM. It is a contentious term because it

is sometimes used in a pejorative sense to exclude from serious consideration theories with which those claiming to have some special insight into Marxism might disagree. Nevertheless, even given the problematic generality of the term, it still seems safe to argue that there are substantial differences between Marxist and neo-Marxist approaches in terms of conceptual, theoretical and epistemological (that is, involving different theories of knowledge) standpoints.

The Marxian heritage

The conceptual, theoretical and epistemological framework of Marxian analysis is both more rigorous and less inclusive than neo-Marxian approaches. A capitalist society is (for Marx) that in which the social relations of production are such that workers are free, in the double sense that they are no longer directly tied to the land/production (free from the means of production) as they would be within feudal social relations. Workers are therefore free from the means of production and must sell their labour-power on the free market for wages, in order to be able to survive physically. At the same time, capitalist society is a very peculiar sort of society, in that – through the process of selling their labour – the worker creates capital through the production of SURPLUS VALUE. Class conflict is endemic to capitalist relations, as workers struggle to claw back some of the surplus value claimed by capitalists who, forced by the laws of the market to engage in competition with other capitalists, try to cut costs and increase productivity by decreasing the share in surplus value available as a return to workers. Translated into practical terms, this means that workers constantly try to maintain wage rates against capitalists who, in turn, tighten labour discipline, as both antagonists seek to defend their conflicting self-interests.

The capitalist therefore ‘exploits’ the worker through the mechanics of the system itself, and Marx therefore stresses that the notion of EXPLOITATION does not imply conscious moral turpitude (which does not mean to say that

Marx has many kind words to say about the capitalist). Marx argues that the way that capital is created and expropriated is systematically hidden from those who create value (the worker – called by Marx the ‘direct producer’) through the structures engendered by the mechanics of the capitalist system. This means that workers could conceive of themselves as free – which in law they are, because they are free to contract their labour with the capitalists on a juridically equal basis. These formally equal relations of production, however, hide actual relations of inequality – between those who own wealth or control the means of production (the bourgeoisie) and those who do not (whom he terms the proletariat). Production, for Marx, is a key concept but it does not refer merely to what happens within the factory or within a given industry or indeed simply to the production of the physical means necessary for human life. All these meanings are part of an inclusive idea that understands production as the production and reproduction of all social life. A MODE OF PRODUCTION, as Marx explains in *The German Ideology*, is ‘a definite mode of life’ (Marx and Engels, 1989 [1846]).

Others before Marx, most famously John Locke and DAVID RICARDO, had operated from within the framework of a LABOUR THEORY OF VALUE. Marx’s contribution was to further develop the labour theory of value to unravel what he understood as the hidden dynamics of the structural inequality embedded within the system of capitalist social relations. Marx’s theory is intrinsically political, in that its aim is to promote an emancipatory project whose intention is to liberate the proletariat and, by extension, the whole of humanity.

Neo-Marxist concepts, theories and epistemology

Neo-Marxism borrows a conceptual and theoretical framework from Marx to explain the ‘modern’ world – dated from the late fifteenth century or the late seventeenth century, depending on the theory – as, first and foremost, a capitalist global economy. The idea of

capitalism is sometimes used by neo-Marxists in a very broad sense to describe a historically specific era characterized by increasingly globalized market relationships of exchange. Sometimes the concept is used in a more recognizably Marxian sense – also to describe a historically specific period, but with some reference to the idea that it is capitalist RELATIONS OF PRODUCTION that define the specific historical epoch. In addition to the concept of capitalism, neo-Marxism utilizes other notions familiar to the Marxian lexicon, including ‘exploitation’, ‘proletariat’ and ‘class’. Some variants of neo-Marxism extrapolate the language of Marx to the international arena by arguing that states can be understood as analogous to classes, in that ‘core’ states should be understood as a ruling class of states that exploit the small and poor states of the ‘periphery’ (see CORE–PERIPHERY MODEL).

Neo-Marxist theory unravels the processes at work in the capitalist global political economy through the utilization of a framework of analysis that considers class as a major factor in international relations; economic relationships as key dynamics, and international justice and equality as key normative concerns. While there is an epistemological diversity of neo-Marxist approaches, with some adopting positivist approaches and others claiming post-positivist or ‘critical’ credentials, the tendency is towards the latter approach – with an important aspect of most neo-Marxist work including an overt commitment to a more equal global community, coupled with some idea that theorization of inequality could contribute to emancipatory outcomes.

Neo-Marxist writing, however, either ignores or rejects the labour theory of value as a basis for understanding modern societies. Marxian concepts are thus exported out of a very specific epistemology and methodology – sometimes known as HISTORICAL MATERIALISM – and utilized in a sometimes insouciant manner. This does not mean that neo-Marxist theories are illegitimate or cannot offer useful and perhaps radical and emancipatory explanations of global political and social life – the

question is rather whether these explanations would perhaps be better assessed within the context of their own ambitions, rather than with reference to a theory whose paradigmatic assumptions they do not share. The consequences of the appropriation of Marxian concepts in a less than rigorous manner can be theoretical confusion and epistemological inconsistency.

Neo-Marxism in the study of international political economy

There are at least three discernible groups of neo-Marxist writing in the discipline. They can be characterized as DEPENDENCY THEORY, WORLD-SYSTEMS THEORY and NEO-GRAMSCIANISM, which came to prominence in (respectively) the 1960s and 1970s, the 1980s and the 1990s. These categorizations usefully describe sets of theories that share certain assumptions and have generated considerable research programmes. Each group also, however, includes a diversity of approaches which differ, among other things, in respect to the extent that the work is informed by concepts, theories and epistemology drawn from Marxian historical materialism.

Dependency theory set out to explain relationships of socioeconomic inequality between states in the capitalist international political economy (IPE). These theories, which attempted to explain relations of dependence and exploitation between states of the North and states of the South, were a response to post-war decolonization when theorists were concerned with trying to explain why, in the wake of political independence, economic independence and growth had not materialized. Dependency theorists argued that fundamental relations of inequality are due to the active exploitation of small ‘less-developed’ economies and/or states and societies by the ‘developed’ capitalist economies/states – thus producing not a lack of development but underdevelopment. Dependency theories did not, however, maintain their cohesion in the wake of the end of the Cold War. Theories that relied on a conceptual framework that under-

stood the South, or the Third World, as possessing a degree of commonality and cohesion became less plausible as these states increasingly demonstrated very big differences in terms of wealth, economic development and general development.

World-systems theory, initially developed by IMMANUEL WALLERSTEIN, shares with the dependency theorists an attempt to explain underdevelopment as the product of international market-based relationships that inherently discriminate against small and 'peripheral' states. The difference was that Wallerstein believed that he could explain the evolution of the entire world system, including the socialist states. He did this by arguing that capitalism should be understood as constituted by market-based systems of exchange (not specific social relations of production as understood by Marx) and, if one could understand capitalism in this way, then one could also understand all states since the fifteenth century as having developed as capitalist. This meant that, for Wallerstein, the Soviet Union and the People's Republic of China were inherently capitalist, because they participated in a market system of international exchange.

Neo-Gramscianism has become a dominant theoretical force within the discipline of IPE. The inspiration is drawn from the work of ROBERT COX, whose seminal work 'Social forces, states and world orders' (1981) synthesized a version of Marxian historical materialism with specific insights drawn from the work of the Italian communist ANTONIO GRAMSCI. Cox is particularly known for attempting to apply to the international arena the Gramscian proposition that hegemonic states maintain their rule through a mixture of consent and coercion. Cox also argued that the global economy should be understood as a series of historical structures, characterized by a fit of material forces, ideas and institutions. Within these historical structures, hegemonic states and societies hold sway at particular points in time – such as, for instance, Britain in the nineteenth century and the United States in the second half of the twentieth century. Cox has been enormously influential, with his work

having an impact over and beyond the group of theorists who consciously build on the very broad neo-Marxist foundations of his work.

Those who have also found illumination from Cox's work include mainstream international political economists who have used Cox to help them think about the role and function of 'hegemonic leadership' in the international system and also those who retain a more central role for Marxist theorizing but have found the Gramscian concepts introduced by Cox helpful as a complement to their theoretical apparatus.

Conclusion

Neo-Marxism, therefore, is an imprecise term that should be used with extreme caution. It can be used to describe a wide range of theorizing which is, very broadly speaking, derived from Marxian theory. Its imprecision, however, means that the term is best avoided as an analytical category.

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HAZEL SMITH

neo-medievalism

As transformations in social, economic and political structures have unfolded over the twentieth century, many international relations (IR) theorists have begun to call into question the viability of the sovereign states system. Amid the contentious debates and various opinions on the topic, one conceptual thread has arisen that sees in the emerging post-modern world order interesting similarities with the Middle Ages. Referred to variously as the 'new medievalism' or 'neo-medievalism', the analogy has become a popular shorthand theoretical marker and a focal point of research for many in the field. In fact, it is the arena within which a question that touches the heart of the political science discipline is being asked: where does political authority ultimately reside today?

Although the idea of a return to the 'medieval' has haunted modern political and social thought since the concept was first formulated in the early modern period, it did not make any significant impact in the IR field until Hedley Bull's *The Anarchical Society* (1977). Certainly the Middle Ages itself had been a topic of study for IR theorists prior to that time. And one can even find scattered allusions to a 'new medievalism' before Bull's usage (Griffiths, 1967: 305). But it was Bull's substantial treatment of the topic that ushered in the conceptual thread and his treatment has become a touchstone ever since.

In a section of *The Anarchical Society* entitled 'Alternatives to the contemporary states system', Bull contemplated the possibility that the sovereign states system might disappear and be replaced by something along

the lines of the medieval model. While conceding that a return to an equivalent of the overarching theocracy of the Roman Catholic Church was out of the question, he suggested that more conceivable would be a return to the model's 'central characteristic: a system of overlapping authority and multiple loyalty' (Bull, 1977: 254). Indeed, even at the time Bull was writing, political and ECONOMIC INTEGRATION in Europe and elsewhere lent plausibility to such a thesis. Bull made it clear, however, that there were both positive and negative potential implications of such a shift. A neo-medieval world order would bind states and peoples together, while checking against the concentration of power inherent in a world government. But it might also create conditions ripe for insecurity and violence, such as those that characterized certain periods of the Middle Ages. These same dualities have informed perspectives on neo-medievalism ever since.

Using Bull's initial probes as a lead, theorists have returned to the analogy, extending themes that he raised and others in a variety of ways. Most popular has been the focus on what Bull called the Middle Age's 'central characteristic': multiple and overlapping layers of authority. In studies of the EUROPEAN UNION (EU) in particular – what John Ruggie calls perhaps the first 'multi-perspectival polity' (Ruggie, 1993) – the neo-medieval analogy has been employed to illuminate how national-state institutions are now sharing sovereignty with supranational and NON-GOVERNMENTAL ORGANIZATIONS (NGOs) (Waeber, 1996). Others have generalized the analogy beyond Europe to include the world as a whole, arguing that political authority is no longer being monopolized by states, but is dispersing to multiple domains: to an emerging global CIVIL SOCIETY, to INTERNATIONAL ORGANIZATIONS (IOs), to global financial and economic institutions (such as MULTINATIONAL CORPORATIONS (MNCs) or bond rating agencies), to transnational criminal organizations and to private security forces (such as mercenaries or tribal warriors) (see Cronin and Lepgold, 1995; Der Derian, 1987; Kaplan, 1994; Kobrin, 1998; Shlapentokh 1996).

Beyond multiple levels of authority, the analogy has also made its way into discussions of private international law, of CAPITALISM as an overarching operating system similar to the Roman Catholic Church, and of consumer culture and virtual reality as cultural equivalents to the otherworldly aspects of the medieval mentality (see Cutler, 1999; Deibert, 1997; Lipschutz, 1992). The latter, in particular, would provide an intersection between IR theorizing and an emerging neo-medievalism in popular video culture and computer games, scrutinized by the likes of Lewis Lapham (1994) and Umberto Eco (1983), and break down the barriers that have separated studies of international political economy (IPE) from wider cultural phenomena.

Of course, the use of the analogy has not gone uncontested. Some – we might call them ‘the moderns’ – have argued that politics in the Middle Ages conform perfectly well to traditional realist models of international relations, touching off a tangential debate of its own between those who disagree (Fischer, 1992; Hall, 1997; Hall and Kratochwil, 1993). Indeed, untrained visitors to the IR field in recent years might mistake it for a subfield of medieval studies, given the amount of published material dedicated to the topic. Other moderns have taken the neo-medieval literature to task on the basis of the extent to which authority has actually dispersed from the sovereign state to other actors. Some feel that the state still wields ultimate authority, especially in juridical matters. They argue that while new actors may have more *power* and *influence* relative to states, they do not have *authority* (Fabry, 1998). Such a shift will not take place, so the argument goes, until it is formally recognized by publics and codified in international law. Much turns, obviously, on the definition of ‘authority’ that is employed. If authority is defined in a strictly legal or juridical sense, as the moderns prefer, then very little dispersal has taken place and there is no systemic overlapping authority. If authority is defined more broadly to include non-traditional and implicit aspects of authority, then it appears that indeed many more actors

than states are deciding today ‘who gets what, when and how’ (Cutler, Haufler and Porter, 1999). Ultimately, the debate between the medievals and the moderns turns on a question as ancient as civilization itself: who has the right to set the rules of the game? However the debate is resolved, the invocation of the medieval analogy suggests a probing search by many theorists and observers for non-traditional concepts to help understand, describe and cope with a changing world order.

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RONALD J. DEIBERT

neo-mercantilism

The term 'neo-mercantilism' was coined to describe the expanded range of motives for governmental intervention in the economy and the ever more elaborate means adopted in the pursuit of such objectives. Neo-mercantilism thus denotes a widening and intensification of the purposes and practices associated with 'traditional' MERCANTILISM.

In its 'bullionist' phase traditional mercantilism focused on the accumulation of wealth, with which rulers could ensure the recruitment and maintenance of sufficient military forces to enable them to defend their territories and

often expand them at the expense of their neighbours. BULLIONISM dictated the pursuit of a positive balance of trade, from which to accumulate revenue.

Simple bullionism, however, gradually gave way to a more general concern with the wider sources of military strength. Systems designed to ensure the recruitment of effective forces in time of war, reliable supplies of material and provisions were added to revenue-generating practices. A significant level of economic self-sufficiency was favoured within this developing mercantilist philosophy, as was the ability to develop favourable relations of strategic DEPENDENCE with other rulers with whom conflict might develop in the future. Traditional mercantilism thus turned on military and political purposes.

The evolving commercial revolution within Europe in the sixteenth and seventeenth centuries, however, saw a further expansion of the purposes and practices of mercantilism. Trade was now increasingly seen as a valuable activity in its own right. The wealth that could be created by trade and commerce was appreciated by rulers, aristocrats and the growing class of traders and entrepreneurs alike. Rulers thus became ever more involved with the support and direction of trade and commerce, through patents, charters, direct equity participation in mercantile ventures and involvement in early colonial initiatives.

Industrialization, the development of mass society and the emergence of democracy in various forms were, however, the decisive factors in driving mercantilism towards its more modern neo-mercantilist mode. The eighteenth, nineteenth and twentieth centuries saw the steady advance of a number of interrelated phenomena: the increasing scale and mechanization of war; the growth of pressures for popular participation in the political processes of states; the development of mass consumption of industrial goods and more advanced services, and the gradual emergence of knowledge-based economies and societies. The combined effects of these developments convinced governments of the need to maintain an active interest in a range of

developments within their domestic economies and in the relations between their economies and the wider international economy.

The course and consequences of World War I exemplified the new range of pressures for governmental involvement in the economy and the breadth of mechanisms through which such intervention could be undertaken. The scale and intensity of fighting in World War I demonstrated the need for industrial mobilization at an unprecedented level by those societies that were to endure the conflict. Indeed, the decades preceding the outbreak of the war saw the governments of a number of the prospective belligerents (particularly Germany and Russia) adopt clear and extensive policies of industrialization as a means of developing military capability and, hence, enhancing political strength.

Experience of the early phase of World War I also demonstrated the consequences for those countries in which governments had neglected key industrial developments – such as that of the United Kingdom, whose chemical industry had been allowed to atrophy in the face of growing competition from Germany, to the point at which it was no longer capable of supplying sufficient quantities of explosives for the artillery or dyes for military uniforms when war broke out.

World War I also accelerated the enfranchisement of the working classes of many of the belligerent countries. Such an extension of political participation reflected, in part, the feeling within ruling circles that the contribution of 'ordinary' men to the war effort had been such as to warrant recognition through admission to the political system and was also partly a response to the growing demand from an increasingly mobilized populace for an increased say in political developments.

A sense of obligation within ruling circles – the creation of a 'land fit for heroes' – also complemented the clear demands from the increasingly enfranchised wider population for a more stable and effective economic and industrial system that would deliver desired goods and services while escaping the damaging cycles of economic boom and bust that

had characterized and disfigured preceding centuries.

World War I did not mark the complete ascendancy of neo-mercantilist purposes and practices. The immediate post-war era witnessed considerable efforts both to crush radical socialist impulses (see SOCIALISM) and to restore the world to its pre-war condition – with the return of Great Britain to the GOLD STANDARD and the dismantling of many of the wartime mechanisms for economic and industrial control. Only in the revolutionary Soviet Union were serious experiments with extensive state control of the economy underway at the end of World War I and only under Mussolini's fascist regime in Italy were half-hearted efforts at state management of the economy initiated within Europe in the 1920s.

The onset of the GREAT DEPRESSION after the Crash of 1929, however, shattered post-war expectations of economic 'business as usual' and placed in train developments that were to lead to an extraordinary level of state control of economic and industrial life, throughout the then industrialized world.

Nazi Germany led the way into the new world of state intervention in the domestic and international development of its economy. The primary elements of the campaign that brought Adolf Hitler to power in the election of January 1933 were the restoration of the prosperity of the German people and the reversal of the indignities that had been imposed on them after defeat in World War I. The main mechanism through which economic activity was revived was that of rearmament, which began to accelerate from 1934 onwards. Germany then sought economic and political power and the creation of a sphere of influence, through the development of mercantilist relationships with the far weaker economies of its neighbours in Central and Eastern Europe (Hirschman, 1980).

The lethal stimulus provided by the rearming Nazi Germany gradually prompted its potential adversaries into their own rearmament: a process which, itself, involved increasing governmental intervention in their domestic industry, through development and

production contracts, the establishment of 'shadow factories' and the tightening of controls over patents, exports and international collaborations.

The outbreak of World War II precipitated an era of even more extensive governmental control of economy and industry than during World War I. The United Kingdom achieved a level of mobilization early in the war that was unprecedented in its scale and in the intensity of governmental intervention within a liberal democracy. The United States undertook rapid government-directed conversion to war production once the Japanese attack on Pearl Harbour precipitated the nation into the war. Nazi Germany, after a surprisingly modest start, achieved effective total mobilization by 1943. The Soviet Union, a command economy before 1941 (see *COMMAND ECONOMIES*), was soon able to produce war material on an impressive scale (and often of an impressive quality), despite the enforced relocation of much of its industry to the east of the Urals in the face of crushing early German military victories.

The experience of World War II impressed three 'lessons' on its participants and observers. The first was that neglect of economic conditions could lead to politically disastrous developments. The second was that societies had to be willing and able to undertake massive government-directed industrial efforts if they were to prevail in large-scale modern warfare. The third appeared to be that governments had now proven themselves to be fully capable of the purposeful and effective direction of national economies for collective purposes. Indeed, when reinforced by the theoretical arguments of JOHN MAYNARD KEYNES in his *General Theory* (1936) in favour of governmental management of the macro-economy to ensure stability and sustained growth, the role of government seemed to be both feasible and desirable.

The foundations of fully-fledged neo-mercantilism had thus been laid, firmly, by the end of World War II in 1945. Government-led wartime economic and industrial mobilization had been both necessary and effective. The

many industrial deficiencies that had been exposed by the early years of the war signalled the shortcomings of governmental indifference towards industrial developments. The popular demand for an avoidance of any repetition of the pre-war Great Depression was reinforced massively by the apparent implications of the teachings of Keynes and by the success of general economic management through the trials and tribulations of war. Political pressures within liberal democratic societies for stability and prosperity merely compounded these 'lessons' of wartime experience.

Many Western societies thus seemed primed to enter the post-1945 world equipped with fully-fledged neo-mercantilist purposes and practices. There was a high level of governmental control and ownership of industry within many Western European societies and extensive governmental involvement in economic and industrial developments even within the United States (the foundations of the *MILITARY-INDUSTRIAL COMPLEX* (MIC)). The trade of many European economies was tightly controlled, with highly restrictive rationing regimes in place for their citizens (intensified in the case of the United Kingdom as it faced a severe post-war *BALANCE OF PAYMENTS* crisis). Policies of macro-economic management (see *MACRO-ECONOMIC POLICY*) were also institutionalized and practised with increasing enthusiasm and growing confidence. With considerable, and possibly decisive, financial assistance from the United States in the form of the Marshall Aid Programme (see *MARSHALL PLAN*), such regimes of regulation and direction helped to ensure a pattern of post-war economic recovery that was remarkable, both in its avoidance of the major *DEPRESSIONS* that had accompanied the cessation of most major wars throughout modern history and in its ability to foster recovery from the unprecedented level of wartime destruction and dislocation.

The post-war world was not, however, one of unqualified ascendancy for neo-mercantilism, at least in principle. The leading victor states of World War II had already committed themselves to broadly liberal economic principles at

Bretton Woods in 1944, before the war had actually ended. The undertakings at Bretton Woods led to the establishment of the influential institutions of the INTERNATIONAL MONETARY FUND (IMF) and the International Bank for Reconstruction and Development (the WORLD BANK – see also BRETTON WOODS SYSTEM). The philosophy of liberal international trade also led, in due course, to the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) which was to oversee a succession of trade LIBERALIZATION negotiations ('Rounds') which produced the progressive reduction of formal QUOTAS and TARIFFS on trade among contracting countries. These institutions, when coupled with the effective hegemony of the United States in the non-communist post-war world (see HEGEMONY, US), underpinned a liberalizing pattern of development within the international economy which, necessarily, served as a constant check on neo-mercantilist impulses.

The extent and significance of the Bretton Woods institutions, and their associated liberal principles, for the development of the post-war international economy should not, however, be exaggerated. The initial post-war recovery of Europe and Japan owed most to a combination of interventionist governments and American financial generosity. Indeed, very few measures of practical and sustained economic liberalization were introduced before the late 1950s. The strength of neo-mercantilist impulses and the ubiquity of such practices is, moreover, evidenced by the length and complexity of the successive rounds of negotiations under the GATT and, latterly, the WORLD TRADE ORGANIZATION (WTO). Until the URUGUAY ROUND, agricultural trade and trade in services and intellectual property had been excluded from the purview of the GATT. Moreover, as formal trade barriers – quotas and tariffs – had been reduced or eliminated, NON-TARIFF BARRIERS (NTBs) to trade had proliferated to become the subject of increasingly complex and acrimonious negotiations among those implementing and those affected by such measures. Regional economic arrangements, such as the EUROPEAN ECONOMIC COMMUNITY (EEC),

had also been tolerated by the GATT, despite their many neo-mercantilist implications, and have only recently been brought under active review and negotiation. Recent, highly acrimonious, disputes between the United States and the EUROPEAN COMMUNITY (EC) over such issues as the European regime for banana imports, European restrictions on hormone-fed beef and the United States' tax concessions to the FOREIGN SALES CORPORATIONS (FSCs) of its own MULTINATIONAL CORPORATIONS (MNCs) further demonstrate the durability of neo-mercantilist impulses and their impact on bilateral and multilateral international economic relations.

A particular problem with neo-mercantilist doctrines is their potentially wide-ranging implications in many legitimate areas of popular concern and/or governmental action. General INDUSTRIAL POLICY may be quite appropriate for a government, yet may involve practices (such as SUBSIDIES or tax concessions) that are, or can be presented as, support for exports or assistance against price-competitive imports. Governments clearly have responsibility for the wider economy and its management through fiscal and/or monetary policy (see FISCAL POLICY; MONETARY POLICIES). However, the tax regime practised by a government may impact directly on the functioning and profitability of firms within its jurisdiction and thereby help or hinder international competitiveness. Monetary policy will also have an impact on the general operational context of firms – making productive investments more expensive if INTEREST RATES are held high or cheaper if interest rates are lowered.

Educational policy is, again, often thought to be a legitimate area of governmental concern. However, expensive programmes to increase the technical capabilities of a society could well affect the competitiveness of its firms, just as their neglect can progressively undermine industrial effectiveness.

There is also a range of other policy areas that are the legitimate concern of populations and their governments, particularly in the areas of personal safety and environmental

protection. These are, however, areas in which regulations often have a direct effect on industrial functioning and, hence, competitiveness. The intentional neglect of responsible regulation in such areas could, in turn, give the industries of neglectful countries a cost advantage, at least in the short and medium term and that, in turn, may become a legitimate subject of complaint and/or trade restraint by governments that do accept their responsibilities or respond to legitimate popular demands for effective controls. One of the most pressing and complex issues facing the WTO in a significant and possibly increasing number of disputes under adjudication is the legitimacy of claims that restrictions on trade reflect legitimate safety or environmental concerns, and the knowledge that a refusal to accommodate such considerations could contribute to the progressive loss of support for the organization, particularly among the populations of the advanced industrial countries.

Neo-mercantilism is thus a potentially pervasive, yet elusive, phenomenon. Its roots lie deep within the impulses of democratic societies and their political institutions. There may be popular pressures to direct or restrict trade for a variety of good, and not so good, reasons. Popular passions can also be aroused by those who have particular interests in securing protection or subsidies for their firms or industries. Politicians in democratic polities are also particularly exposed to widespread pressures on trade issues and particularly vulnerable to pressures arising within their own electoral constituencies (as, for example, in the case of a representative from a shipbuilding area over subsidies for shipbuilding or other measures of protection in this area).

The scope for neo-mercantilism is, moreover, enhanced by the complexity of the modern economy. Tax regimes, monetary policies, research-funding systems, educational policies and programmes, environmental controls, and health and safety regulations all interlink within a complex economy and provide opportunities for trade-promoting policies that can have widespread ramifications. The borders between legitimate and illegitimate support for

an industry and an economy are grey and permeable, and have shifted as different fashions in political economy have come and gone.

The 'traditional' instruments of mercantilism – tariffs, quotas and the direct governmental control of trade – have now been largely delegitimized. Many less direct neo-mercantilist practices are also under increasing threat – a range of NTBs, industrial and trade subsidies, export credits and guarantees and restrictions on foreign ownership of sensitive industries and/or services. Criticism is also increasing of a range of governmental practices that have neo-mercantilist possibilities – general industrial policy, sectoral support measures, regional aid programmes and financial support for RESEARCH AND DEVELOPMENT (R&D) within both the private and the public sectors.

In a world of intensifying economic competition, however, it is unlikely that there will be a definitive and enduring demarcation of legitimate government activity from the illegitimate or that neo-mercantilist impulses and practices will be irreversibly suppressed.

See also:

economic realism; economic nationalism; competition state; developmental state

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R.J. BARRY JONES

neo-realism

Neo-realism is exclusively concerned with developing a trans-historical and systemic theory of international politics. It aims to explain why the anarchic structure of the international system is self-perpetuating and resists being transformed into a hierarchical political order. Neo-realism represents one of the most dominant and controversial theoretical perspectives in international relations (IR). Supporters argue that neo-realism offers the only viable starting point for building an effective scientific theory of international politics. Detractors insist that neo-realism has taken the discipline down a sterile and pseudo-scientific cul-de-sac. By contrast, structural realists (see *STRUCTURAL REALISM*) have endeavoured to use neo-realism as a springboard to reach a more sophisticated understanding of the international system. Although primarily associated with the work of Kenneth Waltz (1979, 1998), his initial ideas have been drawn upon so extensively and have generated so much debate that it is appropriate to treat neo-realism as a distinct school of thought.

What intrigues Waltz about international politics is the persistence and recurrence of phenomena such as war, alliances, arms races and *IMPERIALISM*. Although the nature of the units in international politics has changed dramatically over time, these basic international processes persist whether we are looking at the Greek city states, the Diadochi Empires, the nation-states of Europe or the superpowers that dominated the *COLD WAR*. Waltz's systemic theory of international politics, therefore, is designed to explain why a common set of international processes have recurred throughout world history. Waltz believes that he has

succeeded in this endeavour where all other systemic IR theorists have failed, because he avoids the methodological error of reductionism. For Waltz, reductionism occurs whenever a systemic theory incorporates features of the units in the system under investigation. The theory of imperialism formulated by *LENIN* is considered methodologically flawed, as a consequence, because it is the development of capitalism within certain units of the system that is used to account for the onset of imperialism. Such a theory is considered to be reductionist, rather than systemic, and, as a consequence, incapable of providing a trans-historical understanding of imperialism.

A systemic theory, from a neo-realist perspective, presupposes that the units in a system are constrained by the system's structure. Neo-realists start from the theoretical premise that there are two (and only two) kinds of political structure: one is characterized by anarchy and the other by hierarchy. In hierarchical systems, the units are organized in terms of super- and subordinate relations, whereas, in anarchic systems, the units are all organized on an equal footing. These two divergent ways that units can relate to each other represent the deep structure of any political system. The deep structure generates very different consequences for the way that power is distributed. In a hierarchy, the distribution of power determines whether the hierarchy is steep or shallow. By contrast, in an anarchic system, the distribution of power determines the degree of polarization within the system. Neo-realists distinguish between unipolar, bipolar and multipolar international political systems. The third structural feature that neo-realists have drawn attention to is the presence or absence of functional differentiation. In a hierarchical system, there is always a division of labour, with units having the authority to perform different functions within the system. By contrast, in anarchic systems, self-help prevails. A sovereign unit, therefore, never passes its authority over an essential function (such as formulating its foreign policy) to another unit. As a consequence, neo-realists presuppose that

neo-Ricardian (post-Sraffian) theory

anarchical political systems are made up of 'like units' that are determined to survive.

The chances of survival are seen by neo-realists to be enhanced by two strategies, identified as internal and external balancing. Internal balancing arises as the consequence of emulation. If a state develops a military strategy that helps to withstand an enemy attack, then neighbouring states will also adopt the strategy. But internal balancing does not guarantee survival, because units can enhance their power capabilities by joining forces. Any unit confronted by a coalition of enemy units will also be pushed to seek allies. Neo-realists argue, therefore, that no matter how hard states might endeavour to establish a hegemonic position, the structure of the system will generate an opposing or balancing coalition. A unipolar system, therefore, is seen to be highly unstable; it will give rise to internal and external balancing strategies that will produce a more polarized system. An unintended consequence of states striving to survive, therefore, is the continuous reproduction of the anarchic structure of the international political system.

Neo-realism has been attacked from many different angles. The most fundamental criticism is that the account it offers of international politics is simply inaccurate. Historians have argued, for example, that states are just as likely to bandwagon as balance. Neo-liberals argue that neo-realism fails to accommodate the potential for cooperation in the international system (see NEO-LIBERALISM). Constructivists insist that anarchy is constituted by the identity and interests of the units in the system and can take divergent forms. It has also been suggested that it is possible to link liberal institutionalist and neo-realist ideas to provide a richer understanding of international politics. Structural realists have used neo-realism as the starting point for developing a less parsimonious and more historically sensitive approach to understanding the international system. Waltz continues to insist, however, that these attempts to render neo-realism more accurate misunderstand the nature of theory. Theories, he insists, cannot be judged by their accuracy,

but by the extent to which they help an analyst to explain what is going on in international politics.

See also:

agent-structure relations

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RICHARD LITTLE

neo-Ricardian (post-Sraffian) theory

The term 'neo-Ricardian' appeared in the literature in the 1970s to describe work in economic theory undertaken in the spirit of PIERO SRAFFA. To the extent that Sraffa himself spoke of his work as a return to the standpoint of the old classical economists from ADAM SMITH to DAVID RICARDO, there is some basis for the designation.

The neo-Ricardians dismiss the single-commodity models and simplified notions of capital found in NEO-CLASSICAL ECONOMICS. In their radically different view, the marginal productivities of capital and labour do not determine profits and wage rates, and capital is better understood in terms of a Marxian and Sraffian circulation of commodities.

Neo-Ricardians start from the system (or the technical and social structure) made up of the social process of production (pictured by Leontief Sraffa-type models) and the various institutions (mainly socioeconomic) that reflect permanent features of social and individual life. With distribution exogenously determined (for example, by institutions such as entrepreneurial associations and TRADE UNIONS), the social structure implies a fully adjusted situation made up by the prices of production and the corresponding relative quantities of production, and the absolute level of output and employment being governed by long-period effective demand. The super-multiplier relation expresses how effective demand works in the long run: the long-period (or trend) levels of employment and output are, at any moment of time, governed by autonomous variables (trend government expenditures and exports) times a super-multiplier that depends on various persistent (institutionalized) factors related to consumption, distribution, foreign trade and investment. The fully adjusted situation is (in a neo-Ricardian view) a 'hidden economy' representing a long-period 'equilibrium' that does not, however, imply full employment: the institutionally governed trend-employment may be considerably lower than the full-employment level.

The theory has a number of interesting implications, providing results often opposite to those predicted by the neo-classical model. For example, in the case of regional development, as capital intensity is no guide to profit rates, capital may flow from capital-poor to capital-rich regions and thus accentuate regional imbalances. Rather than increasing returns, this approach explains the concentration of industrial activity in core regions in terms of the balance of class forces, and hence the DISTRIBUTION OF INCOME, and the lower

TRANSPORT COSTS and higher accessibility of these regions.

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ROBERT LOONEY

neo-statism

'Neo-statism' is a political-economic doctrine favouring a state-guided approach to economic reorganization, in which the flexibility of STATE policies is employed so as to guarantee the efficiency of the core industries on the territory governed by the given state. Under neo-statism, the state undertakes a structural policy promoting the national economy's general competitiveness. Elements of such a policy include the multiskilled labour force required by post-Fordist openness (see POST-FORDISM), as well as flexibility in policies of capital accumulation. Whereas NEO-LIBERALISM in general justifies a reduction of the role of the state, neo-statism justifies its expansion so as to guarantee the national economy's structural competitiveness. However, the two strategies are not mutually exclusive. For example, through its 1997 development report 'The state in a changing world', the World Bank brought its ideological evolution away from primitive anti-statism to a point of culmination, seeking to incorporate the state into its programming of a solution to the post-1970s development crisis. This is signalled by such catchphrases as 'good governance' (note how it contrasts with the phrase 'good government'); the report also includes a 'managerialist' approach to the administration of formally sovereign political entities. Such an approach remains subordinate within an overall framework of neo-liberalism,

neo-Weberian approaches

a restriction that is not surprising in view of the World Bank's continuing dependence on private CAPITAL MARKETS.

See also:

economic realism; neo-mercantilism

ROBERT M. CUTLER

neo-Weberian approaches

Among the approaches used in political economy, those referred to as 'neo-Weberian' are generally associated with multi-causal theories or the use of IDEAL TYPES. Multi-causal analysis is committed to the view that the most comprehensive explanations require hypotheses using a variety of possible causal factors. Selection between competing hypotheses proceeds pragmatically, with factors assessed in terms of their usefulness in producing reliable and testable results. Construction of ideal types, either historical (for example, 'capitalism' or 'state') or logical (for example, 'rational actor'), is thought to assist in formulating adequate theoretical explanations.

As a political economist schooled in the problems of the new discipline, MAX WEBER developed his work in two contexts: the reception of Marx's historical materialism and the dispute over 'method' in economics. With respect to the former, Weber came to interpret Marx's base-superstructure model as an important hypothesis useful for research. But he rejected the notion of an ultimate cause, or the view that explanation of all social phenomena could be reduced to a single factor, such as the economic. In his view, the most fruitful theories and most adequate explanations should be based on an analysis of particular configurations, careful construction of type concepts and consideration of the explanatory potential of political and social factors like law, the state and religion. With regard to the *Methodenstreit* ('dispute over methods'), Weber sought to defuse the disagreement between marginal utility theory, as advocated by Carl

Menger, and HISTORICISM, as practised by Gustav von Schmoller and representatives of the German Historical School of economics (see HISTORICAL SCHOOL, GERMAN). Essentially, Weber argued that both construction of formal models of rationality and investigation of historical contexts could contribute to the growth of science. In his view, historians implicitly worked with models of rationality, while formal theorists tacitly relied on historical data – a convergence his unfinished masterwork, *Economy and Society*, was partly intended to demonstrate.

The older disputes have ended in a triumph, often unacknowledged, for neo-Weberian approaches. Today, studies in political economy that focus on large-scale comparative historical questions dealing with institutional change, political and economic transformation, the global expansion of modern capitalism, or the dynamic relationship between state and civil society rest implicitly on neo-Weberian foundations. The effort 'to bring the state back in' follows the logic of neo-Weberian thought, as does the older work of KARL POLANYI or JOSEPH SCHUMPETER, the 'new INSTITUTIONALISM' – or the field of socioeconomics that Weber helped establish. Working with explicit models of rationality and a variety of economic, social and political hypotheses, contemporary scholarship has continued along the path explored by Weber in his critical response to Marxism and historicism.

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LAWRENCE A. SCAFF

NET BARTER TERMS OF TRADE *see* terms of trade

new constitutionalism

The term 'new constitutionalism' refers to a doctrine that is used to place restraints on the democratic control of public and private organizations and institutions that are defined as economic. The doctrine is intended to create confidence in the minds of investors in the long-term sustainability of a profitable investment climate.

Coined by Stephen Gill (1992), the concept of new constitutionalism is useful in analysing the construction of legal, quasi-constitutional or constitutional devices that remove or insulate economic institutions from popular scrutiny and democratic accountability. Whereas straightforward privatization of state enterprises is a rather obvious example of removing certain areas of governance from the public sphere, new constitutionalism often works through more subtle ways of redefining the boundaries of the political. Examples of new constitutionalism may include central bank independence, balanced budget amendments, exchange rate rules, as well as commitment to specific policy rules associated with trade and investment through international or regional agreements, such as the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA).

In international political economy (IPE), constitutional aspects have traditionally been given scant attention. Even within critical IPE approaches to economic policy-making, there has been more attention to the *de facto* pressures exercised by transnational capital than to the *de jure* changes in policy frameworks. The idea of new constitutionalism is an example of how an integrated concept, embedded in a wider historical materialist approach, can expand the reach of political economy analysis. Most importantly, new constitutionalism helps to explain and understand the 'locking-in' of neo-liberal reforms that are intended to be long-term and binding

in nature within and across political jurisdictions (see NEO-LIBERALISM).

From Gill's perspective of transnational HISTORICAL MATERIALISM (sometimes also called NEO-GRAMSCIANISM), the importance of new constitutionalism during the last decades is intimately linked to the structural power of transnational capital and its mobility. As institutional investors and credit-rating agencies have become increasingly important, states have been pressured into minimizing investor uncertainty. By introducing various mechanisms of restraint that limit their future opportunities to deviate from 'sound' economic policy (that is, low inflation and budget discipline), states are attempting to show a commitment to sustaining a good investment climate. This is often rewarded by higher credit ratings and thus cheaper access to capital to finance government activity.

As argued already by F.A. VON HAYEK and MILTON FRIEDMAN, separating questions of economic rule from democratic politics is crucial for stabilizing private forms of authority under capitalism. For Hayek and Friedman, this kind of separation of the political and the economic is a highly desirable feature of capitalism. For example, from their perspective a rational monetary policy is difficult to execute if it can be modified at will by parliaments and other political institutions.

The scholars associated with neo-Gramscianism evaluate the insulation of the economic sphere in much more critical terms. ROBERT COX, among others, has pointed out that the late twentieth-century redefinition of politics, based on the separation of politics and economy, is establishing alarming limits to democracy. In Gill's terms, this separation is ratified by new constitutionalism, which may have become the main discourse of governance for most of the global political economy.

Whereas liberals like Hayek and Friedman emphasize the tyrannical possibilities of political intervention in the sacred sphere of the 'economic', critical IPE scholars such as Cox and Gill tend to regard the politicization of the 'economic' as a necessary condition for the deepening of democracy. Both approaches

New Economic Policy (NEP)

would agree that in capitalism, capital needs to be protected from democratizing pressures. The disagreement lies, ultimately, in the desirability of capitalism as a social system.

See also:

country risk rating; globalization; trilateralism

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TEIVO TEIVAINEN

New Economic Policy (NEP)

Soviet Russia started the New Economic Policy (NEP) in March 1921 to try to recover from the economic devastation caused since the 1917 revolution. It replaced food requisitioning from the peasantry with a tax in kind, largely restored private trade and enterprises, and relaxed labour regulations. The STATE, however, kept control of large enterprises, foreign trade and the banking system. The NEP intensified the BOLSHEVIK leaders' debates

about the appropriate length of the NEP and the role of the peasantry, as well as the degree to which capitalist elements would have to be tolerated in the building of SOCIALISM. The introduction of the first Five-Year Plan (1928-32), which entailed mass collectivization and rapid industrialization, terminated the NEP.

SHOICHI ITOH

NEW ECONOMICS see alternative development

New International Division of Labour (NIDL)

The New International Division of Labour (NIDL) refers to a process of international relocation of production from higher to lower wage countries, which has been accelerating since the 1970s. It is closely related to the concepts of GLOBALIZATION and INTERNATIONALIZATION of production.

The concept of a NIDL was brought into general use by the work of Folker Fröbel, Jürgen Heinrichs and Otto Kreye, in their *New International Division of Labour* (1980; originally published in German in 1977). Using examples from the German textile and garment industries, Fröbel and his associates found that relocation to THIRD WORLD countries was resulting from rising domestic costs, especially wage costs. Once some companies relocated overseas in order to source lower labour costs, competitive pressure on the remaining companies mounted to do likewise.

The NIDL has been facilitated by technical changes which have allowed the production process to be subdivided, with different stages located in different places. Improvements in transport (particularly airfreight) and in communications (such as fax and e-mail) have been crucial to these relocations. Thus labour-intensive processes (such as the assembly of electronic components) can be carried out in

low-wage countries. By confining relocations to repetitive labour-intensive tasks, workers can be trained to achieve a sufficient level of productivity for low wages to translate into low-wage costs.

The relocation to the Third World has been encouraged too by special incentives offered by DEVELOPING COUNTRIES to foreign investors – such as EXPORT-PROCESSING ZONES (EPZs), where taxation is low and a subsidized infrastructure is provided. Attempts are often made by governments in developing countries to restrict trade union activity in order to keep wages low for foreign investors. In practice, many of the workers engaged in export production are female and new entrants to the labour force.

The relocation of production, though starting with firms from Western Europe and North America, has also been a feature of Japanese industry. In Japan, it was driven originally by rising wages and a labour shortage, but partly too by a desire to avoid controls on pollution. In the late 1980s, relocation from Japan also was driven by the appreciation of the yen exchange rate, which made domestic export industries less competitive. The relocations have caused worries about the ‘hollowing out’ of domestic industry and a consequent loss of jobs from labour-intensive activities.

In the 1980s and 1990s, NEWLY INDUSTRIALIZED COUNTRIES (NICs) (such as Hong Kong, South Korea and Taiwan) also have been losing their COMPARATIVE ADVANTAGE in labour-intensive industries, in the face of labour shortages and rising wages. In the case of Korea and Taiwan, an appreciating exchange rate (due to their previous export success) has also accelerated relocation by reducing the competitiveness of exports. In Hong Kong, where shortage of land has made factory sites expensive, large parts of the territory’s labour-intensive manufacturing industry (such as garments, toys, footwear and plastics) has moved into the southern region of mainland China; there are more workers in Hong Kong-run factories in China than in Hong Kong’s own manufacturing sector. In

Taiwan’s case, some industrial sectors (such as footwear) have largely migrated to China. The Asian NICs also have relocated industry to other low-wage countries in the Asian region, including Indonesia.

NIDL relocations have been carried out within large MULTINATIONAL CORPORATIONS (MNCs), which can operate worldwide to reduce costs. However, even in Western countries and certainly in Japan and the Asian NICs, small and medium-sized companies also have relocated production to lower wage countries.

Strong debate has taken place within the Marxist tradition on the origins and significance of the NIDL: is it, for example, driven by a FALLING RATE OF PROFIT (FRP) in industrial countries or simply by the emergence of a worldwide market for labour and commodities, aided by improved transport and communication? It has also been debated whether the spread of capitalism to developing countries via the NIDL is ‘progressive’, in the sense of leading to Third World capitalist development. Within developing countries the expansion of labour-intensive exports may help, in due course, to raise the overall demand in the economy by enough to increase real wages. However, there is a danger in those circumstances of foreign investors again moving to locations where wages are lower.

It is worth remembering that industrial relocations under the NIDL are only part of the globalization or internationalization of production. The NIDL is mainly relevant to labour-intensive industries, especially those where the production process can be subdivided (as in the garment and electronics industries). Also, much foreign investment in developing countries, especially in the larger ones, is in the form of production for the domestic market, rather than labour-intensive exporting. In any case, most FOREIGN DIRECT INVESTMENT (FDI) in the world economy still takes place between industrial countries, rather than from industrial countries to the Third World. Technical change, such as the development of flexible specialization production techniques, has led to the relocation of some

New International Economic Order (NIEO)

labour-intensive production back to Western countries (such as fashion garments and footwear, of which Italy is a major world supplier).

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JOHN THOBURN

New International Economic Order (NIEO)

Formal proposals for a New International Economic Order (NIEO) were put forth by developing countries at a summit meeting of the NON-ALIGNED MOVEMENT (NAM) in 1973. The origins of the NIEO, however, can be traced back to the Havana Conference in 1948, and stem from economic and political tensions that had been building between the developing and developed nations.

On an aggregate level, the economic performance of the developing countries had been

fairly good in the 1950s. By the early 1960s, however, many developing countries were frustrated with their growth prospects and started demanding a better deal. Rallying in such organizations as the NAM, they created the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), where they argued for fairer TERMS OF TRADE and more liberal terms for financing development. The North responded with pious declarations of its good intentions – but also with a hard-nosed insistence that the proper forum for any economic changes continued to be the Bretton Woods institutions where they held the balance of power (see BRETTON WOODS SYSTEM). By the early 1970s, however, the postures of the developing countries were changing:

- 1 A substantial shift occurred in the developing countries' perception of the gains to be had from economic relations with the developed countries under the existing rules of the game; the shift was towards a gloomier view.
- 2 At the same time, the developing countries perceived their own economic and hence political power vis-à-vis the developed countries to be sufficiently substantial to warrant a strategy of effective trade unionism to change the rules of the game and thereby wrest a greater share of the world's wealth and income.
- 3 Finally, a straightforward political desire to participate more effectively in decision-making on international economic matters was evident. Participation was demanded not merely to ensure that the developing countries' interests were safeguarded, but equally as an assertion of their rights as members of an international community and as a desired feature of a just international order.

The success of the members of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC) in increasing oil prices substantially, starting in 1973, served as a catalyst to pull together the developing countries in support of a call for a New International Economic Order in which their interests would be better represented. This call integrated many of the

proposals that had been discussed previously at UNCTAD and in other world forums.

Specific proposals for changes in the economic system were advanced at the Summit Conference of Non-Aligned Nations held in Algiers in September 1973. Following that, the Sixth Special Session of the UN General Assembly was called hastily for April 1974. This session adopted, without a vote, a manifesto entitled 'Declaration and Programme of Action of the New International Order'. In December 1974, the General Assembly approved the Charter of Economic Rights and Duties of States.

The NIEO is essentially an eighteen-clause document that seeks certain changes in the international system that would allow LESS-DEVELOPED COUNTRIES (LDCs) the opportunity to build their way out of the never-ending cycle of poverty. Several main clauses stand out:

- 1 adoption of an integrated approach to price supports for an entire group of developing country commodity exports;
- 2 the indexation of developing country export prices to tie them to rising prices of developed countries' manufactured exports;
- 3 the attainment of OFFICIAL DEVELOPMENT ASSISTANCE (ODA) to reach the target of 0.7 per cent of GROSS NATIONAL PRODUCT (GNP) of the developed countries;
- 4 the linkage of development aid to the creation of the SPECIAL DRAWING RIGHTS (SDRs) of the INTERNATIONAL MONETARY FUND (IMF);
- 5 the negotiated redeployment of some developed countries' industries to the developing countries;
- 6 the lowering of TARIFFS on the exports of manufactures from the developing countries;
- 7 the development of an international food programme; and
- 8 the establishment of mechanisms for the transfer of technology to developing countries, separate from direct capital investment.

The Charter of Economic Rights and Duties of States included two basic and controversial propositions:

- 1 It affirmed each state's full permanent sovereignty over its natural resources and economic activities, which was specifically set out to include the right to nationalize foreign property, without regard to existing international laws.
- 2 It confirmed the right of primary-product producers to associate in producers' cartels and the duty of other countries to refrain from efforts to break these cartels.

The most important provisions in the programme designed to establish the NIEO dealt with the management and pricing of at least ten core commodities: cocoa, coffee, copper, cotton, hard fibres, jute, rubber, sugar, tea and tin, and seven other commodities with slightly lower priority: bananas, bauxite, iron ore, meat, rice, wheat and wool. Specifically, the objectives of the commodity programme were to (1) reduce excessive price and supply fluctuations, and (2) establish and maintain commodity prices that, in real terms, are equitable to consumers and remunerative to producers. To achieve these goals, the following integrated measures were proposed: (1) the establishment of international BUFFER STOCKS, (2) the creation of a COMMON FUND to finance these stocks, (3) the signing of multilateral trade commitments and (4) the arrangement of improved compensatory financing to stabilize export earnings.

Both of the UN documents discussed above lay the blame for the low incomes in the South on past exploitation under COLONIALISM and NEO-COLONIALISM. These terms come from the socialist-Marxist literature (see MARXISM-LLENINISM) that defines as exploitation all commercial activities in which business firms retain any part of net revenue as profits or return to invested capital, rather than paying it all in the form of wages to labour employed by the firm. This proposition follows directly from the Marxist proposition that any net income not going to wages is SURPLUS VALUE. Under colonialism, the instruments of exploitation were the colonial administration; under neo-colonialism, they are the modern multinational enterprises (MNEs).

Confronted by the far-reaching demands for reform of the world's economic and social systems, the North responded by calling for the Seventh Special Session of the UN General Assembly. This session, held in September 1975, was intended to arrive at a North-South compromise and resulted in the issue of Resolution 3362, which was adopted by consensus. This resolution basically endorsed the demands for NIEO, the ideas for price indexation, the 0.7 per cent aid target, the SDR-aid link, and many other provisions originating with the South coalition. The United States and other Northern delegates attached detailed reservations to the resolution, but its passage represented a symbolic victory for the South. The negotiations leading to the resolution had the main effect of changing slightly the militant tone of the proceeding documents and led to the incorporation of some demands for changes and programmes proposed by the United States.

These US proposals centred on the basic principle of maintaining the existing economic system and the provision of development assistance through increased trade liberalization, the transfer of aid and technology through international organizations outside the direct control of the United Nations and the creation of some programmes for the stabilization of commodity prices and the creation of some buffer stocks, of a fund to stabilize export earnings of developing countries, and of agreements on coffee, cocoa and sugar.

At the UNCTAD IV conference in Nairobi in May 1976, the proposals for the establishment of a NIEO were reworded slightly in some instances, but their essence remained unchanged when they were adopted as resolutions, with only the United States and the Federal Republic of Germany voting against them. Most significantly, the conference laid out a timetable for the study and implementation of one of the most controversial proposals, involving the INTEGRATED PROGRAMME FOR COMMODITIES (IPC) – giving it a bureaucratic life of its own and raising exceptions about its ultimate adoption.

As things turned out, the NIEO never became much more than a rallying cry for the South. This failure stemmed partly from the South's lack of power in world politics and partly because disparities within the South created divergent interests among the member-states. Also, it became apparent that many of the proposed commodity schemes were not simply a proposal for stable prices but, instead, for high prices. As such, the financial costs of implementing these programmes were way beyond anything the advanced countries were willing to fund. In the 1980s, the terms of trade further deteriorated for raw material exporters and the debt problems experienced by many of the nations advocating the NIEO forced them on to the defensive in international forums.

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ROBERT LOONEY

new international financial architecture

The debate in the late 1990s over the shape of the 'new international financial architecture' pitted those who would continue LIBERAL-

IZATION of global capital markets, even at the risk of continued crises, against those who sought to minimize future financial instability, even at the cost of diminished international capital flows and/or reduced national regulatory independence. The rise of the issue had its roots in three developments. First, the fixed exchange rate system of international monetary management established at Bretton Woods during World War II (see BRETTON WOODS SYSTEM) had collapsed in the early 1970s, after the United States broke the dollar's link to gold. Second, the United States in the 1970s began a sustained campaign to liberalize international capital flows. 'Financial GLOBALIZATION' – or the rapid expansion in quantity and speed of private cross-border financial flows – dramatically accelerated in the 1990s (Armijo, 2001). Third, currency and banking crises, and international 'contagion' across countries, increased in the 1990s.

Through the early 1990s, most policymakers in the GROUP OF 5 (G-5) (comprising France, Germany, Japan, the United Kingdom and the United States) conceived of reform of global finance primarily as a technical problem. The goal was to minimize the international repercussions of bank failures caused by incompetence, bad luck or fraud – such as the failure of the Bank of Credit and Commerce International in 1991 – while pursuing the advantages of integrated financial markets (Kapstein, 1994). Of course, there were dissidents, like economist James Tobin, who in the 1970s proposed to slow the acceleration and expansion of cross-border financial flows by a universal, mandatory tax on all international capital transactions. Moreover, Western European leaders in the early 1990s began their phased initiation of a common currency, intended to eliminate exchange fluctuations between themselves. Then came the series of financial crises of the 1990s: the near collapse of the European EXCHANGE RATE MECHANISM (ERM) in 1992–3, the MEXICAN PESO CRISIS and spreading 'tequila effect' of 1994–5, the devastating East Asian 'flu' of 1997–8, the Russian default of August 1998, the emergency rescue of US hedge-fund Long Term Capital

Management in October 1998 and Brazil's rocky devaluation in January 1999. Even those who had fully supported liberalization of world capital markets began to believe in the need for fundamental reform.

The 'global financial liberalizers' held that cross-border capital flows were fundamentally efficient and beneficial for world growth, equalizing the cost of capital across different markets. International currency arbitrage (more commonly known as speculation) did not intrinsically increase risk or inequality between or within countries. Since the great powers had a rational self-interest in preventing financial crises, they could and would solve the collective action problem of providing adequate international regulation. In late 1998, the Group of 22 (an 'informal' expert committee organized by the United States) issued three reports illustrative of this approach (Eichengreen, 1999: 130–2). For crisis prevention, the G-22 encouraged further development through the BANK FOR INTERNATIONAL SETTLEMENTS (BIS) and ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) of regulatory 'best practices' (in areas such as banking supervision, capital adequacy, cooperative governance and bankruptcy law) to be implemented nationally and on a voluntary basis. For crisis prediction, the G-22 recommended greater 'transparency' in reporting and accounting, not only for developing countries, but also for the INTERNATIONAL MONETARY FUND (IMF) itself. For crisis management, the committee proposed limited IMF lending into arrears and urged that national regulators in advanced industrial countries encourage the use of loan and bond agreements that would establish *ex ante* creditors' committees and majority voting rules, to be employed in the event of a threatened borrower default. Conspicuous by their absence were suggestions for enforcement mechanisms for the above proposals. The G-22 was only one of several sources of recommendations from this perspective, which broadly represented the views of the US executive branch (and particularly the Treasury Department, historically close to private financial

new social movements

interests), central bankers in most advanced industrial countries, and the IMF. Some financial liberalizers also accepted the merits (for countries with underdeveloped financial markets) of a transitional tax on short-term capital inflows, such as that employed by Chile in the 1990s.

The 'global financial stabilizers', by contrast, judged that increased currency speculation and massive short-term capital flows inevitably undermined international trade in goods and services by making costs and profits so uncertain that rational actors would desist. Crises would aggravate inequality. Purely voluntary cooperation between national regulatory bodies, often private entities self-regulated by participant financial institutions, could not by itself achieve stability: stronger measures were urgently needed. Most financial stabilizers hoped to slow the acceleration of global capital markets by instituting distributively neutral, multilateral controls, such as the 'Tobin tax' on short-term international capital movements. Many also advocated stabilizing exchange rates between the dollar, the euro and the yen, and/or coordinating macro-economic policies between the G-5 countries. More ambitious suggestions envisioned a world central bank with true lender-of-last-resort powers (Jeffery Garten), a supranational credit-rating and insurance corporation (George Soros) or a world bankruptcy court with the power to impose a standstill on asset seizures (Jeffrey Sachs) (Blecker, 1999: 85–146). Many academic economists, particularly those of a social democratic bent, as well as most political leaders in continental Europe and Japan, found themselves in this camp, to which the leadership of the WORLD BANK publicly defected in 1997 8.

As of mid-1999, the incremental reforms preferred by the financial liberalizers looked most likely to be implemented. The best hope that the stabilizers had of their policies becoming politically feasible was for pro-trade interests in the G-5 (particularly the United States) to split from private financial interests, uniting instead with labour, environmental and

other groups around a new banner of free trade but managed capital flows.

See also:

capital mobility; financial integration; systemic risk

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LESLIE ELLIOTT ARMIOJO

NEW MEDIEVALISM see neo-medievalism

new social movements

The 'new social movements' are called 'movements' because they are social groupings less formal than political parties but more organized than spontaneous protests. They are called 'new' because they are said to be distinct from the 'old' movements which were anchored in social classes. The importance of such new social movements to political economy is manifold: they are significant because they have been so successful in attracting committed members, because of the changes in legislation and in public policies which they have helped bring about, and on account of their innovative approach to political activism. Given their flexibility and innovativeness, it is not possible

to give a comprehensive list of new social movements; however, virtually all commentators would agree that the women's movement and the environmental movement are central and paradigmatic examples. An important aspect of the environmental movement's success has been due to the formation of social movement organizations (SMOs), such as Greenpeace and Friends of the Earth; organizations which command recognition internationally and which are as well known as the movement they aim to represent.

The classical social theorists of the late nineteenth and early twentieth centuries anticipated that the industrialized capitalist societies would offer new but coherent identities and that these would lie at the heart of political action and protest in the modern period. Foremost among these theorists was KARL MARX. He and, in various ways, his followers argued that the manifold forms of identity on offer – based on craft, on region, on nationality or allegiance to empire, and even on GENDER – would gradually resolve themselves on to class. Though the Marxist interpretation showed this analytic move in its clearest light, within the social sciences there was a widespread assumption that individuals would come to take on one (or a few) from a small range of identities. Abortion or animal rights were never envisaged as becoming truly important as political causes. Subsequently, many commentators have drawn attention to the emergence of the new social movements which, increasingly through the twentieth century, offered novel collective identities and multiple bases for political action.

At the most straightforward level, it is easy to endorse the majority view about the importance of these new social movements. As mentioned at the outset, they have commanded attention in several important ways: through their success in attracting committed, active and fee-paying members; through their legislative and policy achievements, and through the innovative forms of political activity they have stimulated. For example, in the United Kingdom alone, the environmental movement has between four and six million members (as represented by people

who voluntarily commit money and time to participation in environmental activities). In the summer of 1997, the Royal Society for the Protection of Birds – hardly the most glamorous of organizations – celebrated the recruitment of its millionth member. The total membership of UK environmental groups approaches the number of people who are members of TRADE UNIONS (the ostensible movement of the working class) and far exceeds the numbers that join the Labour Party.

Moreover, social movement activism has secured major social changes. In relation to legislative achievements, the civil rights movement – in the United States, South Africa and Northern Ireland – has won previously excluded minorities the benefits of formal equivalence before the law in matters of voting and has made advances in terms of equality in employment and payment conditions. In relation to political innovation, the women's movement has pioneered new forms of protest and has brought about the politicization of issues (lately domestic violence but formerly a whole range of interpersonal issues subsequently seen as regulated by 'political correctness') previously regarded as quite beyond the realms of the political. Various other activist movements, most notably lesbian, bisexual and gay campaigners and a range of disability movement organizers, have worked to legitimize previously problematic identities and even to convert these once private identities into self-consciously political forms of identification. Equally notable has been the largely unexpected rise of New Age religious sensibilities and practices, as well as the successes of groups (such as nationalists) whose agenda is less obviously 'progressive'. For many strict Marxists and for other social scientists who had assumed that there would be only limited socio-structural alternatives in advanced capitalist societies, the dramatic increase in political identities on offer has been a puzzle and a challenge to deeply held commitments.

If the basic outline of the social-movement phenomenon can be agreed, its interpretation has proven much more contentious. In general terms, two dominant approaches to the

analysis of social movements have appeared. One, the leading US approach, focuses on social movement organizations (for example, the Campaign for Nuclear Disarmament or the World Wide Fund for Nature) and on the competition for members, funds and other resources in which they are forced to engage. It sees the contest between social movements in terms of the resources they are able to mobilize. Briefly expressed, this school of thought suggests that, at any particular time, there are many issues about which members of the public could become exercised. What determines those issues that rise to political prominence is less a function of the qualities of the issue itself than of the moral entrepreneurship displayed by movement activists. This view is supported by the observation that, by the 1980s, several of the more vociferous social movements were actually highly efficient social movement organizations, sometimes followed by few spontaneously active supporters. Analysts drew attention to the importance of organizational and technical innovations such as the pre-printed letter addressed to politicians or senior officials and, especially popular in the United States, records of the voting record of state and federal politicians. Politicians who had once voted for or made favourable remarks about, say, abortion or gun control were likely to have their record resurrected by right-wing pressure groups. Using these methods, professional campaigners could readily create the impression of a large social movement while demanding minimal participation by the movement's 'members'.

For advocates of the analytic approach, the focus is on the 'resources' that movements and SMOs can mobilize. Of course, the fact of one type of movement's success could itself become a resource for another movement to deploy. Legislative or policy advances made, say, by the women's movement become a target to be aimed at by lesbian, bisexual and gay activists, and so on. Furthermore, movements invented their own forms of activism. Thus, it was predominantly gay activists who employed 'outing' (the exposure of covert homosexuality among legislators and policy-makers who were

publicly opposed to, or lukewarm about, gay entitlements). Yet the very flexibility of this notion of 'resources' is both a strength and a weakness of this approach. Though it is clearly correct not to limit in advance the kinds of resources which movement activists can creatively employ, if the term 'resources' is allowed to swell too much, it becomes useless as an explanation.

On top of this, other critics have suggested that this approach over-emphasizes the role of movement organizations: some protest movements appear to be initiated and run by individuals. And some protests (for example, many animal rights campaigns) appear to recruit people through literature and shocking photographs, which can readily be produced by individuals, rather than through the networking activities of sophisticated organizations.

By contrast, the leading continental European approach takes an historicist line (see HISTORICISM). To this way of thinking, 'new social movements' merit that title in so far as they take on the historic role formerly ascribed to classes. As Touraine expresses this idea,

social movements are neither accidents nor factors of change: they are the collective action of actors at the highest level – the class actors – fighting for the social control of historicity, i.e. control of the great cultural orientations [of society].

(Touraine, 1981: 26)

According to such a view, the only movements which qualify for the title 'social movements' are ones that take over the historic agenda of social classes and strive to control the 'great cultural orientations' of society. Behind this diagnosis lies Touraine's assumption that with the change to a post-industrial form of society, class-based actors have been bypassed. The new social movements stand in the same relationship to contemporary society as class groupings did to 'classical' capitalism. Social classes (the basis of the 'old' movements) are succeeded by new social movements that – just like social classes – define a group in whose interests they fight and define an 'enemy' which has to be overcome.

This approach is thus in important ways Hegelian. That is, 'true' social movements are viewed in an historicist way, with the assumption that they articulate the interest of some developing historical actor. As mentioned above, this impression is easy to reinforce since many social movements share a 'progressive' orientation. But there appears to be no non-arbitrary way of separating the 'true' from other movements. The difficulty is to decide which movements qualify. Civil rights movements might well, but how about the youth movement? What separates a 'great cultural orientation' from one that is less than great?

Those scholars not firmly aligned to one school or the other commonly believe that a full understanding of new social movements requires a synthesis of these two approaches. In a shorthand way, one may say that the first approach is better at accounting for the 'how' of social movement action, whereas the second has more to say about 'why' certain social movements are timely and significant. However, so far the many well-meaning attempts to relate the two have not succeeded in bridging the divides. Furthermore, rather little attention has been paid to new social movements outside the advanced industrial countries. Both schools of thought have tended to assume that new social movements are the product of advanced capitalist/free-market democratic societies. But the success of certain environmental and women's movements in underdeveloped countries suggests that such forms of political organization can adapt to a variety of social circumstances. In some cases, this adaptation is assisted by the movements' universalistic ideologies: the advocates of ENVIRONMENTALISM believe that they operate in the global ecological interest of all, while women's movement activists commonly assert that they act in the interest of women everywhere.

Finally, other scholars have attributed significance to the fact that the multiplication of movements and identities has not stopped with the establishment of new social movements. For example, the women's movement has begun to divide internally over the realization that there is no single women's interest.

Instead, there are differences of culture, ethnicity and sexuality which have the potential to divide women. Unlike the early assumption that women's needs were shared and widespread, the argument is now increasingly heard that there are a multiplicity of women's identities, so that no one woman or women's organization can be expected to speak for all. Rather than view this profusion of group cultures as a problem, an alternative strategy is to offer an enthusiastic embrace for this multiplicity of identities – a move most commonly associated with POST-MODERNISM. The specification of definite, delimited identities is viewed as a modernist conceit, exposed by post-modernist cultural developments.

In the hands of other commentators, this turn is viewed less as *post*-modernity than as reflexive modernity. The plight of the women's movement is, according to this view, an example of the application of the sectarian arguments for women's interests to FEMINISM itself. Just as the women's movement deconstructed the universalistic assumptions of 'the rights of man' to show that women's rights were not necessarily identical to those of men (most notably over reproductive rights, but also over pornography and 'free' speech), the needs of women can fall prey to the same manoeuvre. These interpretations suggest that the new social movements are themselves not likely to prove stable entities, but will often be driven by the logic of their ideologies to fracture and schism.

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STEVEN YEARLEY

new trade theory

Modern versions of traditional formal international trade theory combine the principle of COMPARATIVE ADVANTAGE (first formulated by DAVID RICARDO) with the HECKSCHER-OHLIN-SAMUELSON (HOS) MODEL OF TRADE, which is based on differences in relative FACTOR ENDOWMENTS between trading countries. The traditional theory is designed to explain the direction and volume of international trade. It is also used to discern the effects of such trade policies as TARIFFS, import or export SUBSIDIES, and import QUOTAS. The theory has been developing over the last 150 years or so, and has reached a high state of refinement.

The implications of the theory are clear and straightforward. Arguments from WELFARE ECONOMICS are used to show that all countries gain when international trade takes place compared to when there is no trade, although not every person in each country is better off. Policies that tend to reduce trade (tariffs, quotas) reduce total economic welfare, though they may increase the welfare of the country imposing the policy since the TERMS OF TRADE may improve for them; but the welfare of its trading partners goes down by more. Countries export those commodities which require, for their production, relatively intense use of those productive factors found in relative abundance locally. In general, a particular good tends to be exported by one country holding the comparative advantage and imported by the others. Export subsidies reduce welfare. Other detailed conclusions like these can be drawn from the theory.

However, since the 1970s the traditional theory has appeared increasingly inadequate. The problem is two-fold:

- 1 The traditional theory assumes PERFECT COMPETITION, no ECONOMIES OF SCALE and no PRODUCT DIFFERENTIATION. Much of international trade involves goods produced by firms and industries where none of these characteristics hold.
- 2 Intra-industry trade grew as a fraction of total international trade, some estimates putting it now at over one-half the total trade. Intra-industry trade is not possible under traditional theory.

International trade theorists confronted these issues by developing a new trade theory where both the assumptions and the implications of the theory more closely matched the real world. The lessons of the traditional theory are not negated, but a new set of factors and conditions are added that make many of the theoretical and policy implications far more ambiguous than those of traditional theory.

The first step in the new theory was to assume that production takes place under conditions of scale economies. This implies that perfect competition cannot obtain, so as a second step – IMPERFECT COMPETITION is explicitly assumed. Some models also assume that products are differentiated. Since there is no standard imperfect competition model, some particular form had to be chosen. Much of the theory was developed assuming the MONOPOLISTIC COMPETITION model to characterize the industry structure. Under these circumstances, instituting trade where there was none will increase the potential market for these products and lower average costs of production. This presents both trading partners with opportunities for gains from trade that were not present with the traditional models. Thus, there can be gains by trading even when the traditional theory would predict that no trade at all would take place – for example, if factor endowments are identical. The direction and volume of trade can be quite different with this new factor added than had been suggested by traditional trade theory. Under rather ordinary circumstances, intra-industry trade is predicted.

With the new theory, there is no guarantee that trade will increase economic welfare. The standard comparative advantage forces will work to increase welfare, but – as the imperfectly competitive forms come to dominate trade – there may be an increase in monopoly distortions that will decrease the net welfare gain, and may turn it negative. Not all countries may share in the welfare gain, even if the worldwide gain is positive.

The results of using trade policies may also differ under the new theory compared with the traditional results. A protective tariff or quota may reduce the output of the protected industry; an import subsidy might improve the terms of trade; a tariff may reduce internal process. Traditional theory predicts the opposite effects in every case. Conflicting forces are at work (as noted in the previous paragraph on economic welfare) for these and other trade policies, and the ultimate answer depends on the empirical strength of these forces. No such ambiguity exists for the traditional theory. The results in the new theory depend crucially on the behaviour of the firms in their respective markets. Many different patterns can exist under different manifestations of imperfect competition.

FREE TRADE is not an optimal policy under the new theory. However, even with the traditional theory setting of perfect competition in all industries and unrestricted trade, it is not likely that welfare is maximized anyway. Internal taxes, EXTERNALITIES and distortions in the factor markets all work to drive the economy from the maximum welfare position. Most analysts would still advocate as free trade as possible to get as near an optimum position as possible. The imperfectly competitive markets add still another distortion. Empirical evidence suggests that this distortion is small. Imperfect competition itself does not result in a strong, systematic case against free trade.

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MARK B. SCHUPACK

NEW TRANSATLANTIC MARKET-PLACE AGREEMENT (NTMA) see Transatlantic Free Trade Area (TAFTA)

new world order

Invoked at different times during the twentieth century, a 'new world order' has been the objective of leaders and governments, describing their version of a better, more peaceful world. Even more generally, a 'new world order' emerges after major wars in which victors dictate the rules of international life. Currently, it is a term used to describe (sometimes derisively) the post-Cold War world and specifically a US conception of the world in which democratic capitalism predominates.

The history of this term is not a noble one, especially if one considers the invocation of a 'new order' by the fascist government of Nazi Germany. The world envisioned by communists (and particularly by the Soviets)

was one without nation-states and the wars that are inherent in the never-ending rivalries between nation-states. With the rise of the global proletariat and the withering away of the state, war would be eliminated. It was supposed to be a world of plenty and justice: 'from each according to their ability; to each according to their need'. Later it became the world of the new Soviet citizen, living and defending the ideals of communism. But the communist true believers underestimated the strength of NATIONALISM and statehood, loyalty to which inevitably came before loyalty to the communist new world order. Like the Nazi world order, the communist one served as state propaganda intended to promote loyalty and productivity among the proletariat.

The notion of new world order was resurrected with a fanfare in the early 1990s. During the build-up to the 1991 ground war in the Persian Gulf, US President George Bush called for a 'New World Order'. His call was a response to the end of the COLD WAR (if not quite yet the end of the Soviet Union, which would come shortly thereafter) and the brazen way in which Iraq invaded Kuwait in 1990. Bush described a new world order grounded in five central principles: peaceful settlement of disputes, solidarity of states against international aggression, arms control, a rejuvenated United Nations (UN) able to perform peace-keeping functions and the just treatment of peoples. While the latter principles are arguably ethical in content, the others were clearly an effort to promote state interests through the promotion of international order. They were not particularly new ideas and Bush's call did little to change the behaviour of states or other important international actors. Indeed, many argued that the 'New World Order' was merely a unipolar world dominated by the United States, US culture and free markets.

Nevertheless, while the new world order that Bush envisioned does not yet obtain, the post-Cold War world is certainly 'new' in many ways. Perhaps nowhere is this more evident than in the processes of GLOBALIZATION (whereby borders are becoming extraordinarily diffuse with regard to the movement of goods,

services and people) and in the effects borne by the microelectronics revolution (particularly the spread of communications technologies, the dissemination of information and the burgeoning of global media, all increasingly beyond the control of national governments). For some, these changes are viewed as democratization of global affairs, moving authority downwards away from the state and towards the people; for others, these changes bring uncertainty, instability and chaos, something that is new (or atavistic) but hardly orderly. These changes weaken national governments and force poor states to submit to the will of powerful states, multinational corporations (MNCs) and the forces of global capitalism.

Indeed, many would argue that, at the beginning of the twenty-first century, we are living in a new world *disorder*, manifested by the breakdown of states (for example, Ethiopia-Eritrea, the Soviet Union, Yugoslavia), nationalist and ethnic conflicts (such as those in the Balkans, Central Africa, Mexico, South and South-East Asia), floods of refugees, economic collapse in Africa and parts of Asia, and environmental destruction on a global scale. Others point out that, while these things are certainly happening, they are not especially new but are rather more noticeable now than previously.

See also:

hegemony; global society; governance, global

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PAUL G. HARRIS

newly industrialized countries (NICs)

The term 'newly industrialized countries' (NICs) has been used to describe a group of countries, the composition of which varies from one source to another. The adoption of the term reflected a growing differentiation among THIRD WORLD countries and a recognition that not all countries that were included in this category were predominantly agrarian economies. Its narrowest definition included the four East Asian NICs (Hong Kong, Singapore, South Korea and Taiwan) and the two largest Latin American economies (Brazil and Mexico). However, other countries were also sometimes included, such as Argentina, India and Yugoslavia, and more recently Indonesia, Malaysia, the Philippines and Thailand.

Although there are no hard and fast rules for classifying an economy as newly industrializing, the main criteria have tended to be that either they experienced rapid industrial growth (as in the case of the East and South-East Asian economies) or they have a large industrial sector in absolute terms (India and the Latin American countries). Seen from the

point of view of the advanced economies, these countries were significant potential competitors in the international market for manufactured goods.

Given that most development theories have seen industrialization as an important factor in economic growth, there has been considerable interest in the performance of the NICs. This has given rise to conflicting interpretations of the development experience of this group of countries. Orthodox economists see the most successful of these economies (those of East and South-East Asia) as exemplifying the virtues of a small state, an open or export-oriented economy, and 'getting prices right' in their domestic markets. They are regarded as models for other LESS-DEVELOPED COUNTRIES (LDCs) to follow. Indeed, it is often claimed that the South-East Asian economies have done precisely this and have emerged as second-tier NICs in the wake of the four East Asian tigers.

However, this view of the NICs has been strongly challenged by the developmental statist approach, which sees a strong, relatively autonomous state as having played a crucial role in the development of the NICs. The state has been a major actor in countries such as South Korea and Taiwan, in both raising the rate of capital accumulation and influencing its composition. It has protected domestic industry, while at the same time promoting exports; it has tried to discourage speculation, ensuring that investment is channelled into productive activities. The state was able to do this because of particular conjunctions of internal and external conditions.

Both these approaches emphasize the economic success of the NICs, while often having diametrically opposed views on the causes. A third view, which has its origins in DEPENDENCY THEORY, is much more critical of the economic and social performance of the NICs. This view points to the superexploitation of workers, the sacrificing of agriculture, the destruction of the environment and the authoritarian political regimes which have characterized most NICs. They also point to the vulnerability of the NICs as a result of their

niche specialization

dependence on foreign markets, technology and finance.

There is little doubt that the East Asian NICs have made significant advances, not only in terms of per capita income levels but also as measured by social indicators such as infant mortality, life expectancy and literacy. In all these respects, they are now much nearer to the levels of the high income countries (and in some cases ahead of them) than they are to the other countries of the Third World. The experience of the NICs and whether it can be replicated is therefore of central relevance to the debate on the possibilities of capitalist development and the nature of the international system. However, NICs (especially Indonesia, South Korea and Thailand) suffered serious, though possibly temporary, setbacks as a result of the 1997-8 ASIAN CRISIS.

See also:

developmental state

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terms of the adoption of 'market-friendly' policies.

RHYS JENKINS

niche specialization

Michael Porter's hypothesis of strategic market niches attempts to explain why the observed size distribution of firms is strongly skewed towards small entities. The quantitative preponderance of small firms is a very robust universal empirical observation. It is widely confirmed over time across industries and nations. However, it is not *a priori* clear why it should be so. On the contrary, a large body of empirical evidence (reinforced by compelling theoretical arguments) suggests that large firms typically experience important cost advantages through ECONOMIES OF SCALE. Furthermore, there are strong indications that a large fraction of the small enterprises are operating below the so-called 'minimum efficient scale of output'. All this raises the questions: why do so many small firms exist and how are they able to survive?

The basic idea behind Porter's explanation is that, thanks to inter-industry barriers to mobility, small and large enterprises within the same industry are not compelled to and do not engage in the same activities. Rather, small firms can create a 'market niche' – that is, can make the strategic choice of specializing in innovative, high value-added products that are not offered by their larger concurrent. Market niches, however, can also arise in the case of homogeneous products, with the smaller firms specializing in the production of a subset of the goods offered by the larger ones, using a distinct, more efficient production technology. In any case, occupying a niche allows the small firm to avoid competing directly with larger ones and to attain a higher profitability.

The niche hypothesis has a number of potential implications. Clearly, the higher profitability of smaller firms suggests favouring the organization of national production around concentrations of small firms organized cooperatively, rather than around large, verti-

cally integrated structures. That is, governments should promote the growth of small firms, in particular (but not only) through the encouragement of education and information to promote competence niches. Also, helping firms to internationalize their sales and possibly their production may be crucial, since the demand for the products of firms exploiting a specialized technological market niche is likely to be confined to a few clients located in different parts of the world.

The strategic niche concept, however, remains largely descriptive. It does not provide a full-fledged theory of the emergence and survival of small firms. In particular, it fails to explain why the niche activities are not integrated within the large firms. Possible answers to this and similar questions may be found in the approaches of new theories of industrial organization, heavily focusing on strategic behaviour under conditions of asymmetric risk and information.

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CHRISTOPHE DEISSENBERG
NATHALIE GRAND

nichihei economy

The increasing interdependence of the US and Japanese economies into a supposedly joint economy is called *nichihei* in Japanese: a blend of the Japanese characters for Japan (*Nihon*)

and the United States (*Beikoku*, or rice country).

ROBERT GILPIN popularized the term in the United States in the mid-1980s (see Gilpin, 1987). At that time, Japanese firms had stakes of 50 per cent or more in 342 US manufacturers. Japanese subsidiaries employed more than 100,000 Americans. The capital inflow from Japan to the United States was a reflection of large Japanese BALANCE OF PAYMENTS surpluses and increasingly high US deficits, brought about by the US government's increasingly large budgetary deficits.

Gilpin's concern was that – despite the fact that Japanese financing was becoming vital to supporting short-term growth in the US economy – in the long term, continuing dependence would most likely further weaken US power and strengthen that of the Japanese. For Gilpin, the United States found itself caught in a vicious circle. On one hand, the country required foreign capital to finance its budget deficit; on the other, the availability of foreign capital caused a greatly overvalued dollar that decreased the competitiveness of the US economy and weakened its industrial base. A weakened economy, in turn, increased the need for foreign capital with the drain of increased interest payments further undermining the competitiveness of the economy.

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ROBERT LOONEY

Non-Aligned Movement (NAM)

The Non-Aligned Movement (NAM) summit of heads of states of over 110 nations met for the twelfth time in Durban, South Africa, in August 1998. In part, the last such summit of the century constituted a celebration of South

non-banks

Africa's majority rule and return to the global community; it also recorded the NAM's consistent support for the anti-apartheid coalition since the former's founding in the mid-1950s at the height of both the COLD WAR in the North and nationalist struggles in the SOUTH. In part, it also marked the NAM's evolution in the post-bipolar and post-apartheid era away from old security and development issues towards an agenda for the dawn of the new millennium – that is, democratization, GLOBALIZATION, new security and so on. Symptomatic of this transition has been the fragmentation of Yugoslavia (one of the founding members) and the establishment not of a secretariat but of a parallel think-tank: the South Centre. Given the elusiveness of a NEW INTERNATIONAL ECONOMIC ORDER (NIEO) in the 1970s, advocated and advanced by the UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) (and its associated GROUP OF 77 (G-77) in particular), the South Centre emerged out of the SOUTH COMMISSION of the late 1980s (South Commission, 1990) as an international research and advocacy institution advancing innovative Southern perspectives on global economic and political issues, such as reform of multilateral institutions, economic negotiations and so on – that is, it advanced the old UNCTAD agenda. In Durban, for the first time ever, there was an alternative NAM meeting for NON-GOVERNMENTAL ORGANIZATIONS (NGOs), designed to advance non-state, CIVIL SOCIETY perspectives on issues on the NAM agenda (such as reform of multilateral institutions, new security threats, SUSTAINABLE DEVELOPMENT and so on).

See also:

South Commission; South-South

Reference and further reading

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Further information can be found on the web at <http://www.southcentre.org/>

TIMOTHY M. SHAW

non-banks

In many countries, there was traditionally a separation between commercial banks (which took deposits and made loans) and other financial firms, such as trust companies, insurance companies and securities firms. The term 'non-banks' was used to refer to these other firms as they began carrying out functions that had previously been carried out solely by commercial banks. There were concerns that non-banks would have an unfair competitive advantage, because they were not subject to the same level of regulation as banks, and that this would produce a downward pressure on regulatory standards.

TONY PORTER

non-governmental organizations (NGOs)

Non-governmental organizations (NGOs) are entities that are neither profit-making commercial organizations nor part of the governmental sector. This area of organizational activity is often referred to as the 'third sector', as distinct from the private and public sectors (see PUBLIC SECTOR). NGOs represent an important aspect of CIVIL SOCIETY in the areas that they inhabit. While a very wide range of entities fit the criteria of being neither governmental (public sector) or commercial profit-making enterprises (private sector), the terms 'NGO' and 'non-governmental organization' have mostly been used to refer to particular types of agencies that are non-governmental.

The most common exclusions from the many and varied definitions of NGOs are paramilitary insurgency groups, political parties and religious orders. This leaves an extremely large (and incredibly diverse) set of organizations. Indeed, NGOs can differ completely and fundamentally in terms of size, funding, influence, personnel, focus, area of operation, management structure, mission and geographic location – to mention only a few of many possible factors. While there is no such thing as a 'typical' NGO, examples of NGOs that have tended to be cited as paradigmatic have been large well-known INTERNATIONAL NON-GOVERNMENTAL ORGANIZATIONS (INGOs), such as international human rights lobby group Amnesty International, the AID and DEVELOPMENT agency Oxfam and environmental lobbyists Greenpeace. However, the vast majority of NGOs are small, locally based organizations with limited resources and influence, that are concerned with or operational in many more areas (and are generally considerably more diverse) than those agencies listed above.

A bewildering array of classifications and acronyms have been used to try to quantify, explain and subcategorize the NGO sector. Indeed, Ian Smillie comments that more time has been spent naming and renaming NGOs than has been spent trying to understand them (Smillie, 1995: 22). While there are literally hundreds of synonyms, acronyms and subcategories pertaining to NGOs, given below are some of the more widely used variations – with particular agency examples. Local groupings are often referred to as 'community-based organizations' (CBOs), or as 'grassroots organizations' (GOs) or 'grassroots-based organizations' (GBOs) – examples are the Central Scotland Dyslexia Association, Abenaki Indian Center in New Hampshire and the Calgary Multicultural Kitchens Project. NGOs are also known in the United States as 'private voluntary organizations' (PVOs) – for example, Save the Children (USA) or Aid to Artisans (Connecticut). Aid agencies are also sometimes known as 'non-governmental development organizations' (NGDOs) – examples being

Concern Worldwide and Action Against Hunger. There are NGOs that are non-profitmaking, but that represent commercial interests (for example, Alberta Barley Commission in Canada, Irish Business and Employers' Confederation (IBEC) and National Small Business United in the United States), and when they have an international dimension they are referred to as 'business international non-governmental organizations' (BINGOs) – for example, the Canadian Institute of Energy or the International Association of Drilling Contractors. Organizations that receive their funding from governmental sources but are not formally administered by departments of the governmental/public sector came to prominence in the 1980s. These types of NGOs are referred to as 'quasi-autonomous non-governmental organizations' (QUANGOs) – these include the Countryside Commission of England – or 'government organized non-governmental organizations' (GONGOs) – including the Chinese Human Rights Study Society. The acronym 'NGO' is also recognized in many non-European-based languages in the THIRD WORLD as referring specifically to those organizations that work within the development field.

While non-profitmaking and/or charitable status are important aspects of NGOs, it would be wrong to see these organizations as entirely 'voluntary' and without salaried staff. Although often relying heavily on volunteers, many NGOs employ at the very least a core staff. A few of the largest INGOs employ hundreds of individuals (for example, Amnesty International, CARE and Oxfam family) and these organizations have relatively little in common with small local voluntary organizations. NGOs are usually formed by an individual or groups of individuals with an interest or commitment to a particular project or issue.

In terms of understanding an NGO, it is important to analyse where a particular organization acquires its operating funding, what its particular mandate and goals are, and is its mission and management. NGOs can raise resources directly from the general public (either nationally, regionally or locally) through

non-governmental organizations (NGOs)

private foundations, commercial or governmental sources, and often a combination of these. Since the 1990s, the growth in number, power and resources of certain NGOs has been largely led by the willingness of governments and multilateral institutions to fund (and in some cases directly subcontract to) particular NGOs, while also relying on them to a certain degree for advice and specialist knowledge. While a few NGOs have policies of not directly receiving governmental funding (for example, Refugees International), a significant number of NGOs receive a large percentage of their overall budget from governmental sources, either directly or indirectly. This has led some analysts to question how independent and *non-governmental* these organizations actually are.

The growth in the total numbers and influence of NGOs has been a global phenomenon in the post-World War II era. It would seem that worldwide NGOs number well over the 100,000 mark; however, no authoritative figure exists in terms of a total number of NGOs, not just because of the dynamic nature of the evolution of these organizations, but also because of the different definitional criteria used and the fact that registering and reporting the broad sector of organizations that would qualify as NGOs is often not undertaken in a coherent fashion. However, by whatever definitional criterion used, there has been steady growth in the total number of NGOs since World War II, particularly since the mid-1980s. While it is possible to contend that the number of non-governmental organizations is on the increase throughout the world, this development is not universally consistent from country to country, region to region or locality to locality. In many countries, the NGO sector is not nearly as powerful (in terms of number, resources and influence) as others. This often relates to whether the country concerned has a history of organizations that were outside the public and private sectors, and how much past and present governmental authorities have tolerated such entities. It also has to be acknowledged that organizations that are non-profitmaking in nature may have difficulty sustaining themselves in poorer areas of the

world, where alternative sources of public funding or aid are limited or non-existent.

The growth and development of the NGO sector has generally been seen in a positive light, although this opinion is often based on impression rather than analysis. A number of issues surrounding the NGO sector have generated concern, including how accountable these organizations are and to whom, and the quality of their personnel, services and advice given. These questions have even greater pertinence given the increased amount of government funds channelled through NGOs since the 1980s, the growth in the total number of NGOs and also the enhanced advocacy role of these organizations. Generally, more critical analyses of the mandates and operations of NGOs have been a feature of the 1990s and this is set to continue into the twenty-first century.

NGOs, as organizations of the third sector, are important actors domestically and are increasingly influential actors in many areas of international political economy (IPE). From foreign aid and economic policy through to human rights and environmental concerns, NGOs have often been not only at the forefront of action but also influencing other more powerful actors.

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ANDREW M. SHERRIFF

non-tariff barriers (NTBs)

The terms 'non-tariff barriers' (NTBs), 'measures', 'interventions', 'restrictions' or 'distortions' are often used interchangeably to describe policy instruments, other than TARIFFS, that directly or indirectly affect international trade and production. There is a large variety of NTBs. The UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD) uses a classification of over 100 measures – including tariffs with a discretionary or variable component; the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) lists some 150 measures in agriculture alone.

NTBs may be broadly classified according to the intent or immediate impact of the measures (although, in practice, most measures have price and volume effects on trade, production and economic welfare):

- 1 Measures to control the volume of imports

include prohibitions and quantitative restrictions (QRs) or QUOTAS on imports, as well as export restraint agreements (ERAs). Licences are often used to administer QRs. ERAs consist of VOLUNTARY EXPORT RESTRAINTS (VERs) – including those under the WORLD TRADE ORGANIZATION (WTO) Agreement on Textiles and Clothing, and the former MULTI-FIBRE ARRANGEMENT (MFA) of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) – and orderly marketing agreements (OMAs). International commodity agreements, such as the INTERNATIONAL COFFEE AGREEMENT (ICA), can have similar effects.

- 2 Measures to control the prices of imported goods include minimum, reference or trigger price and variable levies, which link the amount of duty to the difference between world and domestic prices. They also include tariff quotas, anti-dumping DUTIES, countervailing measures, voluntary export price restraints and prior IMPORT DEPOSITS. Government procurement procedures often provide a price preference for domestic goods.
- 3 Price and volume investigations and surveillance, often used to monitor possible DUMPING and SUBSIDIES by foreigners, may have a harassment effect. Licences are sometimes used for monitoring, which may be a prelude to other trade actions.
- 4 Production and export measures, such as subsidies, may be paid directly to production or exports or indirectly to material or other production inputs (such as credit or insurance). Tax exemptions or reductions can operate as subsidies. Prohibitions, quotas and taxes may also be imposed on production or exports. Local content schemes (often used in the AUTOMOBILE INDUSTRY) promote the use of domestic parts, as do export performance requirements linked to the right to import some parts duty-free. In service industries, the regulatory and investment frameworks can be used to restrict access for foreign firms.
- 5 Technical barriers ensure compliance of imported products with domestic health or safety standards. Non-complying imports

North American Free Trade Agreement (NAFTA)

may be prohibited or cost-increasing modifications introduced.

More than one NTB may be used at the same time: for example, import restrictions and export subsidies protect the domestic market while developing exports. EXCHANGE CONTROLS and restrictions can be used to ration scarce foreign exchange between sectors and, hence, work like NTBs.

The effects of an NTB can vary between countries or at different points of time in one country: for example, if the world price of a product rises above the domestic support price, then a variable levy would not be applied (although the mechanism to do so when required remains in force).

Various approaches have been used to measure NTBs. Under the inventory approach, UNCTAD has catalogued import measures by type, by product and trade partner affected, and by dates of application and termination. Econometric models may be used to study the effects of particular NTBs in certain sectors. Despite certain weaknesses, a widely favoured approach is to compute the tariff equivalent or price wedge between domestic and world prices as a result of an NTB. This estimate may also then be used in national or global simulation models to study wider trade, production and welfare effects. More limited approaches include estimating the 'consumer' or 'producer subsidy equivalent' (CSE or PSE) of a measure, especially in agriculture, or the EFFECTIVE RATE OF PROTECTION, incorporating NTBs as well as tariffs. The Trade Restrictiveness Index (TRI), developed by Anderson and Neary (1994), is mainly used to measure changes in the restrictiveness of trade policy over time for an economy or sector of the economy.

The reasons for using NTBs range from the long-term desire to promote certain social and economic objectives (including broad economic, industrial or regional development) to shorter-term purposes such as BALANCE OF PAYMENTS support or action to protect a specific sector from import surges or from dumped or subsidized imports. Price- or volume-control measures or subsidies have

been used extensively in the past for industrial development reasons by developed and DEVELOPING COUNTRIES for INFANT-INDUSTRY PROTECTION.

While the WTO bans the use of some NTBs, many WTO agreements provide for exceptions and set out the rules under which specific NTBs may be used. The URUGUAY ROUND is expected to lead to a reduction in the use of some important NTBs – including, for example, ERAs on textiles and clothing, export subsidies and farm production support.

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SAM LAIRD

North American Free Trade Agreement (NAFTA)

The North American Free Trade Agreement is a precedent-setting trade liberalization agreement that was the first to involve both

developed and developing countries. It was signed in December 1992 by Canada, Mexico and the United States and went into effect on 1 January 1994. The agreement contains far-reaching commitments that will completely liberate trade and investment in North America over a specific period of time. It includes innovative 'side agreements' on labour and the environment, issues that have not been included in any previous trade agreement, plus an agreement on import surges. And it sets a standard for creating a hemisphere-wide Free Trade Area of the Americas (FTAA).

The trade regime

Efforts to negotiate a free trade agreement for North America began after Canada and the United States concluded a free trade agreement in 1988. President Carlos Salinas de Gortari of Mexico, following six months of informal discussions, made a formal request in June 1990 to open negotiations with the United States. For President Salinas, such an agreement was seen as a way to prevent Mexico from becoming an economic backwater as trade blocs emerged in other parts of the world, and to 'lock-in' the ambitious economic liberalization policies he had begun in the mid-1980s. The United States also had a stake in an agreement with Mexico, not only because it promised new commercial opportunities for US firms, but because it could lead to a more prosperous and politically stable neighbour. By the time the talks got under way a year later, Canada too had decided to participate, creating a prospective market equal in size to the EUROPEAN UNION (EU) and the EUROPEAN FREE TRADE ASSOCIATION (EFTA) combined.

Negotiations were completed in mid-August 1992, producing a draft document that called for tariff reductions over periods of five to ten years for most products and fifteen years for the most trade-sensitive ones. It also spelled out detailed rules of origin, more open government procurement procedures, certain investment guarantees, a relaxation of Mexican restrictions on foreign participation in its

energy and financial sectors, and procedures for settling disputes.

In addition to the tariff-reduction schedules, the agreement eliminates import prohibitions, QUOTAS and LICENSING. Each country, however, retains the right to impose border restrictions in some circumstances. For example, these are allowed to protect human, animal and plant life. They also may be applied to protect health and the environment.

Special rules were negotiated to liberalize trade in automobiles, textiles and agriculture. Provisions for trade in automobiles required both Canada and Mexico to reduce tariffs by 50 per cent immediately on cars and trucks; the remaining tariffs would be phased out over ten years. NON-TARIFF BARRIERS (NTBs) would also be lifted. The United States would reduce tariffs on Mexican light trucks immediately to 10 per cent, with the remainder to be phased out over five years. Tariffs on all other vehicles from Mexico would be eliminated over ten years. Mexican restrictions on used-car imports would be phased out over fifteen years.

The rules of origin for automotive goods specify that passenger cars, light trucks, engines and transmissions must have at least 62.5 per cent North American content. For all other vehicles and parts, 60 per cent regional content is required. Goods not conforming to these rules can participate in liberalized trade under certain circumstances. They can qualify, for example, if the non-regional content comprises no more than 7 per cent of the total price or cost of the product. Such goods can also qualify if they have been sufficiently transformed, meaning that they have undergone a change in tariff classification.

In what is known as a 'yarn forward' rule of origin, most textile products (fabrics and apparel) must be manufactured from yarn produced within the trade bloc to qualify for free trade benefits. Textiles using non-regional fabrics that are in short supply in the North American region (for example, silk, linen and some shirting fabrics) come under a 'fiber forward' rule and can qualify. Textile and apparel producers are allowed special protection when they face serious damage from

increased imports. The protection can be in the form of quotas when the products do not conform to regional rules of origin or tariffs when they do. US quotas on Mexican textiles that conformed to the rules of origin were to be eliminated immediately and gradually phased out for those that did not.

In the energy sector, Mexico is exempted from US-Canadian rules aimed at maintaining oil price stability and supply security, retaining its constitutionally based state control over virtually all forms of energy. Mexico did agree to ease some restrictions in this sector. For example, supply contracts can be freely negotiated throughout the region and bonuses can be paid to oil subcontractors that strike oil, although Mexico will continue to ban risk contracts on oil exploration by foreign companies.

Mexico also agreed to relax some restrictions on foreign participation in its financial sector. In banking, US and Canadian institutions are permitted to double their cumulative market share (from 8 to 16 per cent) with individual banks taking no more than a 20 per cent cumulative share by the year 2000. After that time, NAFTA banks will be limited to individual market shares of no more than 4 per cent in Mexico. Other investment provisions include elimination of performance requirements for NAFTA investments, plus guaranteed free exchange convertibility and transferability of foreign currency. Furthermore, intra-regional investments will be protected from discriminatory expropriation and will be compensated at full market value with interest for all permissible expropriations.

Other provisions of the agreement opened up government procurement procedures to intra-regional suppliers (defence excepted), phased out restrictions on cross-border land transportation, and eased movement of businesspeople and professionals. Investors from all three countries were to enjoy MOST-FAVOURLED-NATION treatment and non-discriminatory access to public telecommunications networks was also to be made available.

Procedures for settling disputes emphasize consensus. Complaints involving anti-dumping and countervailing duties will be reviewed by

special bi-national panels. The panels replace domestic courts in such matters, but the panels must apply domestic law. If any party disputes a panel's ruling, a tribunal of judges from the countries of the disputing parties is formed. If the tribunal rules against the panel, a new bi-national panel must be formed. Additionally, a high-level Trade Commission was set up, with committees and working groups, to review disputes. If the commission fails to reach unanimous agreement on a case, an arbitration panel is created. Any country refusing to accept decisions emerging from these procedures is subject to retaliatory measures by the aggrieved party.

The special case of agriculture

As is so often the case wherever trade rules are concerned, agriculture has a special status within NAFTA. In the first place, the agricultural portion of the agreement is not even multilateral, but three separate bilateral agreements. Canada chose not to reopen its earlier pact with the United States, fearing loss of hard-won exemptions for certain products, and decided instead to negotiate separately with Mexico. Canada's agreement with Mexico, however, is very similar to the US-Mexican agreement, with the important exception that Canada is allowed to protect its dairy, poultry, egg and sugar industries (that is, Section 22 products). Fear of losing protection of these products in the 1988 free trade agreement with the US was a large factor in Canada's insistence on separate agriculture talks.

The agricultural portion of the free trade agreement spells out terms for completely eliminating barriers to farm trade over a period of not more than fifteen years. To strike the bargain, Mexico agreed to liberalize field crops in exchange for US opening of its horticultural markets. Fifty-seven per cent of the value of bilateral US-Mexican agricultural trade fell under rules requiring immediate liberalization. Another 6 per cent was to be phased in over a period of five years, while the more sensitive products were given ten- and fifteen-year transition periods. About 94 per cent of

bilateral trade in farm products would be traded freely after ten years.

Special transition rules were devised to handle those products considered to be the most trade sensitive. Duty-free trade rules would phase in over transition periods of ten or fifteen years and with added protection under a system of 'tariff-rate quotas' (TRQs). Under TRQ provisions, no tariffs are imposed within certain quotas, but are added when imports exceed the quotas. Products considered 'highly sensitive' were given a ten-year transition with TRQs; those considered 'super sensitive' were accorded a fifteen-year transition with TRQs.

A special safeguard provision, known as 'snap-back', was devised to protect against the damaging effects of import 'surges'. When duty-free imports of certain products rise above pre-established trigger levels, the importing country may re-impose the tariff. (This provision appears in all three of the bilateral agricultural agreements.) Rules of origin are specified to guard against US concern that third countries might trans-ship products through Mexico to gain duty-free access to the US market. The treaty further allows each country to maintain farm subsidy programmes, although it calls for their reduction and commits both parties to work towards support policies that do not distort trade. An additional provision of some importance is that restrictions currently in place affecting trade with third countries will remain unchanged under NAFTA, thus creating a preferential agricultural market for the three NAFTA signatories.

Supplemental agreements

During the US presidential campaign of 1992, Democratic candidate Bill Clinton showed little enthusiasm for the free trade agreement that had been negotiated by his Republican opponent in the face of opposition from many congressional leaders in Clinton's own party and from organized labour, an important constituency of Democrats. In fact, Clinton repeatedly expressed reservations similar to those raised by NAFTA's opponents. He

insisted that any agreement should protect workers, farmers and the environment on both sides of the border. Many viewed such statements as an indication that Clinton might renegotiate the agreement if elected.

Soon after winning the election, however, President-elect Clinton rejected any notion that he would reopen the pact for renegotiation. Instead, he announced his intention to negotiate separate supplemental agreements ('side agreements') on labour and environmental issues, and on import surges. Although these side agreements sought to achieve several objectives, such as environmental clean-up and the creation of higher worker standards, they were aimed principally at ensuring the enforcement of each country's existing domestic environmental and labour laws. Clinton's pledges clearly were meant to deflect criticisms mounted by opponents of NAFTA, many of whom had supported his election.

When the agreements were concluded in August 1993, it was apparent that some of the provisions were not as tough as Clinton had sought, and certainly not as tough as many opponents of NAFTA had hoped. Most importantly, the supplementals did not contain stiff terms permitting the imposition of trade sanctions on another country for failure to enforce its own labour and environmental laws. This had been a key demand of organized labour and some environmental organizations, and was one reason why they were never persuaded to support NAFTA ratification.

Still, the accords were significant. Important new mechanisms were agreed upon to monitor each country's compliance with its environmental and labour laws. Two commissions were set up for this purpose: the Commission for Labor Cooperation and the Commission for Environmental Cooperation. In addition to monitoring compliance, each commission can establish special panels to investigate complaints and to recommend fines or other sanctions. The imposition of penalties will only be possible when a specific and lengthy process of consultation fails to resolve disputes. Fines for non-compliance can only be levied against countries, not businesses, and the commissions

North American Free Trade Agreement (NAFTA)

cannot compel payment. But if a country refuses to pay fines levied, the commissions may authorize the other two countries to raise tariffs in retaliation.

The supplemental agreement on import surges permits additional, though temporary, protection measures beyond those allowed under the 'snap-back' provisions spelled out in the basic agreement. Such measures were designed to deal with large unexpected surges in imports that might result from NAFTA.

Assessment

The NAFTA treaty is hardly an agreement among equals. When the agreement went into force in 1994, the US GROSS DOMESTIC PRODUCT (GDP) was about \$6.7 trillion, compared to Canada's \$530 billion and Mexico's \$350 billion. The impact of NAFTA can be expected to be far greater on Canada and Mexico, simply because any additional trade and investment that NAFTA may generate, even if equally distributed between all three members, will be much larger relative to the smaller economies.

By the time NAFTA came into force, investment and trade flows between the three countries had already received a substantial boost from the US Canadian FTA and by the effects of Mexican economic reforms undertaken by Presidents Miguel de la Madrid and Carlos Salinas. Between 1990 and 1995, US trade with its NAFTA partners grew faster than its trade with the rest of the world. Mexico is now the third largest market for US exports and Canada is the largest. This has happened despite the MEXICAN PESO CRISIS that struck in December 1994, involving a badly managed devaluation of the peso that produced a huge run on Mexico's currency, a collapse of its stock market and a US-organized rescue package of \$50 billion.

The rescue package and the discipline imposed by NAFTA rules softened the impact of the financial crisis, largely confining the greatest effects to 1995. US and Canadian exports to Mexico declined (though by a much smaller percentage than during a similar

Mexican crisis in 1982). But, by 1996, trade figures were showing increases of 20 per cent within the region, with US and Canadian exports to Mexico on the rise as the Mexican economy recovered. It is, perhaps, most important that NAFTA rules and commitments constrained Mexico from raising tariffs and erecting other import barriers as a way of dealing with the crisis. In the past, the almost instinctive response by Mexico would have been to assume a protective posture. NAFTA prevented this by restricting Mexico's latitude to impose import controls and encouraging Mexican officials to use macro-economic means (for example, tighter fiscal and monetary policy) to deal with the crisis.

The result of these measures was that Mexican exports to its NAFTA partners increased at a time when export earnings were crucial to its ability to deal with its large balance-of-payments problem. Moreover, FOREIGN DIRECT INVESTMENT (FDI) in Mexico, which had already begun to rise as investors anticipated NAFTA, continued to increase even during the 1995 crisis, when investment grew more than \$5.5 billion. Today, FDI in Mexico exceeds \$50 billion, more than 60 per cent of which comes from the United States. Most of the worst fears of NAFTA's critics concerning US job losses have not been realized. Some jobs have been lost as production and trade patterns shifted, but many of the losses would have occurred anyway, because of the inevitable effects of GLOBALIZATION. The larger reality since creation of NAFTA has been huge increases in new jobs in the United States, although it is not clear how many can be directly attributed to NAFTA. Obviously, US fiscal and monetary policies starting with President Clinton's 1993 deficit-reduction budget did much to stimulate job growth.

It is difficult to evaluate the respective performances of the two separate commissions on environmental cooperation and labour cooperation. Each was slow to organize and has not had time to establish much of a record. Critics argue that previous environmental problems have not been corrected under NAFTA and that adverse labour practices

have not changed. But NAFTA's critics have been slow to accept the premise reflected in the side agreements that each country must enforce its own laws, regulations and standards. What can be said is that the side agreements created innovative institutions for resolving disputes in two areas not previously part of trade agreements. Because of NAFTA, these issues now are being raised in other trade forums, such as the WORLD TRADE ORGANIZATION (WTO).

Implications for a FTAA

After NAFTA was ratified, expectations ran high for expanding the agreement to include other countries in the Western Hemisphere. Many countries consider incorporation into NAFTA to be the 'Holy Grail' of political and economic policy. In December 1994, the United States joined thirty-three countries at the Western Hemisphere Summit in Miami, Florida, in calling for a Free Trade Agreement for the Americas (FTAA) to be established by 2005. NAFTA members agreed to begin informal talks immediately with Chile, thought to be the best positioned for early incorporation, with the goal of starting formal negotiations by early 1995.

Formal talks were delayed because of strong opposition from organized labour in the United States and from leaders in President Clinton's own political party. Also, many congressional Republicans raised objections to including labour and environmental issues in the negotiations. These forces combined to defeat renewal of 'fast-track' negotiating authority (see FAST-TRACK AUTHORITY), which requires trade agreements to be submitted to Congress for ratification in a deadline-driven, no amendment, 'yes' or 'no' vote on the entire treaty.

Whether the FTAA could be resurrected remains an open question. It is possible that President Clinton had exhausted much of his 'free-trade capital' and simply did not have enough left to win renewal of fast-track authority. After all, Clinton won approval for both NAFTA and the URUGUAY ROUND of GENERAL AGREEMENT ON TARIFFS AND

TRADE (GATT) negotiations (which created the WTO) in the same year. He followed that in 1994 with a push to expand the forum on Asia Pacific Economic Cooperation (APEC) to include all the Pacific developed economies by 2010. And all of this was done against the backdrop of the costly Mexican peso rescue, which was politically unpopular with many elements in the US Congress.

These accomplishments were impressive by any measure. When considered in the context of continuing trade deficits and what were then stagnant real wages for many US workers, it is easy to conclude that they contributed to 'liberalization fatigue' within Congress and the general public, and to concede the possibility that it would take time before Congress and the US public again became ready to take on expansion of NAFTA. Clearly, creating an FTAA is not easy, but the standard set by NAFTA has wide appeal in the region, especially among those who support neo-liberal reforms (see NEO-LIBERALISM) and see an FTAA as a way of preserving those reforms.

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WILLIAM P. AVERY

North Atlantic Treaty Organization (NATO)

Also known as the Atlantic Alliance, the North Atlantic Treaty Organization (NATO) is a mutual defence pact set up in 1949 to counter the threat of Soviet aggression. Its original members were Belgium, Canada, Denmark, France, Iceland, Italy, Luxembourg, the Netherlands, Norway, Portugal, the United Kingdom and the United States. Greece and Turkey joined in 1952, West Germany in 1955 and Spain in 1982. In 1999, three former members of the Soviet camp (the Czech Republic, Hungary and Poland) also joined.

NATO is not an integrated army but a set of political and military instruments and procedures aimed at bringing together, if necessary, the national military forces of member-states and assuring that they work together efficiently. Member-states decide their level of defence spending independently. This has led to many debates about the fairness of burden sharing. Political disagreements and rivalries have also occasionally plagued NATO. France withdrew from the integrated military structure (although not from the Alliance) in 1966 and, as a consequence, NATO headquarters were moved from Paris to Brussels; Greece and Turkey almost went to war with each other over Cyprus in 1974.

NATO's main political institution is the North Atlantic Council. Chaired by a Secre-

tary General elected by the members, the council meets twice a year at the level of foreign ministers or heads of government, and weekly at the level of permanent representatives. Decisions are taken unanimously. NATO's military structure consists of two integrated commands, one responsible for Europe (SACEUR), and the other for the North Atlantic (SACLANT).

The collapse of the Soviet Union, the dismantling of the Warsaw Pact and the signing of a security cooperation agreement ('Partnership for Peace') with former Pact members, have created a new security environment that has obliged NATO to rethink both its role and strategy. According to its 'New Strategic Concept', developed through the 1990s and approved in 1999, NATO has shifted its emphasis from readiness to repel a military attack on its eastern borders to developing a preparedness to meet threats whose source, character and strength are more difficult to predict. They might come from rogue states or terrorist groups and take the form of nuclear, biological and chemical (NBC) weapons, sabotage, organized crime, disruption of the flow of vital resources, or massive and uncontrolled population movements. The new security strategy also calls for NATO's diplomatic and military intervention beyond its borders to manage crises that risk spreading and creating a threat to the security of its members. The first out-of-area intervention of this kind has been the one against Yugoslavia in 1999.

As a consequence of its strategic revision, NATO has also launched the so-called 'Defence Capability Initiative', aiming at improving its information-gathering technology, boosting its ability to project power across longer distances and improving inter-operability among member-forces. It is not clear whether in the future NATO will (or even should) seek authorization from the United Nations Security Council (UNSC) or the Organization for Cooperation and Security in Europe (OCSE) before engaging in out-of-area military activities or will act unilaterally as it did in Yugoslavia in 1999.

Although NATO has survived the end of the

COLD WAR, it remains to be seen whether it will also survive a more integrated Europe. As the EUROPEAN UNION (EU) develops its COMMON FOREIGN AND SECURITY POLICY (CFSP) and attempts to revitalize the Western European Union (WEU) as its future defence arm, the possibility exists that the WEU will replace NATO as its main defence organization. It is more likely, however, that the new WEU will simply reinforce a European security and defence identity within NATO.

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OSVALDO CROCI

Nurkse, Ragnar (1907–59)

Ragnar Nurkse was born in Estonia. He was educated at the University of Tartu (Estonia) and in Edinburgh and Vienna. Between 1934 and 1945 he worked as an economist in the Economic and Financial Department of the League of Nations. He moved to the United States in 1940 and was naturalized in 1948. He held appointments at the Universities of Columbia and Princeton, and at the time of his death was a professor at Columbia University.

Nurkse's two best-known and influential books were *International Currency Experience: Lessons of the Inter-War Period* (1944) and *Problems of Capital Formation in Underdeveloped Countries* (1953). The former was published by the League of Nations and did not carry Nurkse's name. It reflected how his ideas had been influenced by the experience of the 1930s, in particular his concern for full employment, the importance of effective demand-management and the international coordination of economic policies. *Problems of Capital Formation* was probably a more important and influential work, bringing together inter alia

Nurkse's concern with the concepts of vicious circles, big push and critical minimum effort theses, and BALANCED GROWTH strategies.

Nurkse defines a vicious circle as a:

circular constellation of forces tending to act and react upon one another in such a way as to keep a poor country in a state of poverty. (Nurkse, 1953: 4)

The most widely quoted example of a vicious circle is with respect to capital accumulation. The low level of real income in 'underdeveloped areas' resulted in a limited capacity to save and was itself a reflection of low productivity. The latter was largely the result of the lack of capital, which is the result of the limited capacity to save; thus the circle is complete.

The demand side is equally important. The inducement to invest may be low because of the limited purchasing power of the population, due to low real income resulting from low productivity. The latter results from the limited use of capital in production, which in turn may be at least partly caused by the low inducement to invest. Nurkse's dictum that '[t]he inducement to invest is limited by the size of the market' (ibid.: 6), echoes ADAM SMITH's dictum that 'the division of labour is limited by the extent of the market' (Thirlwall, 1994: 182). The size of the market is determined by productivity, which in turn (as argued above) is largely determined by the use of capital in production, but where the small market limits the inducement to invest and hence discourages the application of capital. The way out of this

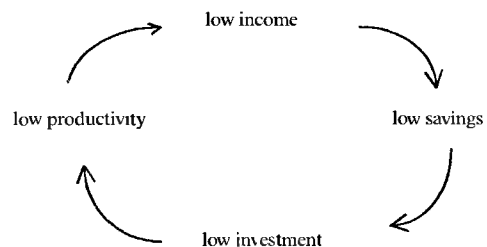


Figure 8 Example of a vicious circle

dilemma is balanced growth, interpreted to mean both (1) the large-scale expansion of activities to overcome divergences between private and social returns – that is, a level of investment necessary and sufficient to overcome indivisibilities on both the demand and supply sides of the development process (Rosenstein-Rodan's 'big push'), and (2) a path of development and a pattern of investment necessary to keep the different sectors of the economy in balance so that the lack of development in one sector does not impede development in others. This did not imply that output in all sectors should grow at the same rate, but rather each should grow in accordance with the INCOME ELASTICITY OF DEMAND for products so that supply equalled demand (ibid.: 181–3).

Nurkse explicitly dealt with the problems of the international economy. He believed that exports of manufactured goods to the industrial economies were likely to grow slowly or even be blocked, and that even improvements in the TERMS OF TRADE of primary-product exporters (Nurkse was writing in the aftermath of the primary-commodity boom induced by the Korean War) would not automatically be translated into higher levels of savings and investment. Hence the balanced growth argument. In this respect, balanced growth became associated with planned development and so-called 'inward looking strategies' of IMPORT SUBSTITUTION INDUSTRIALIZATION (ISI),

which had fallen out of fashion by the early 1970s.

Nurkse's other major contribution was the argument that DISGUISED UNEMPLOYMENT in overpopulated peasant economies contained hidden sources of savings that could be made available for economic development. This disguised savings potential (Nurkse, 1953: 37) could be realized as long as those already in productive occupations did not eat more when the surplus labour was withdrawn – that is, the surplus food would be used to feed the previously unproductive workers, who would now be mobilized to create capital. Nurkse was not unaware of the complications and difficulties of such a strategy (the mass mobilization of labour in Maoist China is perhaps the best example of this strategy in practice). As Todaro (1994: 96) notes, many of the basic ideas of dual sector models were to be found in Nurkse's work.

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FREDERICK NIXSON



OCTOBER WAR *see* Yom Kippur War

off-balance-sheet instruments

During the 1970s and 1980s, banks became increasingly involved in selling various contingent commitments (such as note issuance facilities) which guaranteed support to an issuer of notes, if the notes were not all purchased in the market. While these added to the profitability of banks, regulators became concerned that the risks involved in these commitments were often poorly understood, underpriced and (because they were not reflected in balance sheets) not subject to traditional forms of regulation. Indeed, the tendency of banks to substitute off-balance-sheet activities for traditional lending was in part an effort to minimize regulatory costs and created a downward pressure on regulatory standards. More generally, the proliferation of off-balance-sheet activities was part of the process of **SECURITIZATION** – the displacement of lending channelled through the bank's internal organization (bank-intermediated lending) by more arm's length transactions, such as the direct raising of funds in capital markets by corporations through the sale of securities.

Concern over off-balance-sheet activities led the **BASLE COMMITTEE ON BANK SUPERVISION** to incorporate them into the 1988 agreement on **CAPITAL ADEQUACY STANDARDS**. Eight categories of off-balance-sheet activities, differentiated by the degree of risk involved for the bank, were established: each was assigned a 'credit conversion factor', ranging from 0 to 100 per cent, by which the commitments were

made comparable to traditional loans and incorporated into the regulatory calculations. Since 1988, more complex **DERIVATIVES** (also forms of off-balance-sheet commitments) have become an increasing concern for regulators relative to the types of credit guarantees that were more characteristic of off-balance-sheet activities in the mid-1980s, and efforts have been made to update bank regulations to reflect these changes.

TONY PORTER

Official Development Assistance (ODA)

The **DEVELOPMENT ASSISTANCE COMMITTEE (DAC)** lays down four conditions that have to be satisfied in order for flows to qualify as **Official Development Assistance (ODA)**, which is the most commonly used definition of **AID**. The first three conditions follow from the term itself:

- 1 *Official*: The funds have to come from an official (that is, governmental) agency – they may be either bilateral or multilateral (see **AID, BILATERAL**; **AID, MULTILATERAL**), but monies raised by **NON-GOVERNMENTAL ORGANIZATIONS (NGOs)** are excluded (money channelled through NGOs by official agencies is included, however).
- 2 *Development*: The primary purpose of the funds must be developmental, thus excluding export credits and military assistance.
- 3 *Assistance*: The funds must be concessional (that is, lower interest and longer maturity than market terms).

The final condition is that the recipient country must be on the DAC list of aid recipients.

The expression Official Development Finance (ODF) applies to flows which meet all but the third condition.

HOWARD WHITE

offshore finance

The term 'offshore finance' has no precise meaning and, unfortunately, 'offshore' means quite different things to different people. It is often employed loosely to denote any type of transnational financial operation. On the other hand, the BANK FOR INTERNATIONAL SETTLEMENTS (BIS) and the INTERNATIONAL MONETARY FUND (IMF) label regional centres which did not grow organically (that is, TAX HAVENS) as offshore financial centres. In the more prevalent use, offshore banking consists of financial services performed (primarily) for non-resident borrowers and depositors. The principle attraction of an offshore banking centre (for banks as well as participants) is simply the absence of intrusive and expensive official regulation, including taxation and control over the portfolio decisions of the banking community (Scholey, 1994). In this sense, the offshore financial market has come to replace the EUROMARKET. While the euro-market originally evolved in London and Paris, the offshore financial markets now span the entire world and consist of a number of markets.

The literature distinguishes four types of offshore financial centre (Park, 1982): 'primary centres' (such as London or New York) that serve worldwide clients and act as international financial intermediaries for their market regions; 'booking centres' (such as Nassau or the Cayman Islands) which are used by international banks as the location for 'shell branches' to book both eurocurrency deposits and international loans; 'funding centres' (such as Singapore or Panama) which play the role of inward financial intermediaries, channelling offshore funds from outside their markets

towards local uses, and 'collection centres' (such as Bahrain) which engage primarily in outward financial intermediation. Such a hierarchy is testimony to the degree of specialization and interdependence among offshore centres. These disparate financial centres are linked in what is commonly described as 'the offshore financial markets'.

An alternative typology distinguishes between the 'spontaneous' off-shore sites (such as the United Kingdom and Hong Kong); International Banking Facilities (IBF) (such as New York and Tokyo); and tax havens, at the last count consisting of over seventy states (Palan and Abbott, 1996). The 'spontaneous offshore centre' in the City of London (see LONDON, CITY OF) is so called because it allegedly grew up accidentally through the attempts by the UK government to re-establish London as the centre of global financial activities after World War II. An IBF is a more stringent type of offshore market, in which companies must apply for a licence to trade. The New York IBF emerged towards the end of the 1970s as the result of a prolonged and complicated battle between the US Treasury, the Swiss government and a number of Caribbean tax havens. The New York IBF was established on 1 December 1980. In turn, the creation of the New York IBF spawned the creation of the Tokyo IBF. Singapore's IBF for the Asian Currency Units (ACU) was established in 1968. Every offshore centre functions additionally as a tax haven, though the tax haven proper may be identified as the least restrictive category of all three.

The development of offshore banking operations as a whole should be considered in the broader context of the general process of internationalization of economic activities involving trade. In large measure, it is the product of controls and regulations on domestic financial systems. The most important characteristics of offshore banking markets are their relative freedom from direct regulation and their specialization in wholesale banking transactions. As such, these markets tend collectively to function as distribution mechanisms for shifting funds on a global scale

from lenders to borrowers or to deficit spending units. The economic rationale for offshore banks is therefore that they can perform this distribution function more efficiently.

Since offshore financial markets have widened the access of companies to loan markets, the argument goes, they have brought down borrowing costs relative to the underlying level of interest rates. Due to reduced costs, competition from offshore financial markets has forced the liberalization of domestic markets. As a result, today only the imposition by some central banks of non-interest-bearing reserve requirements on domestic bank deposits remains as a major domestic regulation favouring eurocurrency transactions. Because costs have fallen, companies can borrow in whichever market is most advantageous to them and swap proceeds into the currency they need to spend. If this was the case, however, three things should have happened:

- 1 The gap between offshore and onshore interest rates should have so diminished as to become insignificant. This has indeed been the trend since the late 1980s (Frankel, 1993).
- 2 If capital was fully mobile, then it should have flown from countries with low real interest rates to those with high real interest rates until the two had evened out. This has largely not happened, it is argued, because of diverging risk between countries.
- 3 If capital was perfectly mobile, there would be no reason for domestic savings and investment to be linked: funds would flow from countries with high savings to those with the best investment opportunities. In practice, high-saving countries have high rates of investment and vice-versa. Most savings are still invested in their country of origin.

Most economists agree, therefore, that a fully functioning global financial market is yet to be established. Nonetheless, it is evident that the offshore financial markets are increasingly dominating world finance.

Arguably the greatest long-term impact of offshore finance lies elsewhere (Palan, 1998). Offshore evokes images of the high seas, of a

world beyond borders. This is not the case: offshore financial transactions do not take place on a barge floating in the ocean. On the contrary, offshore financial transactions are very much 'onshore' – conceived, organized and handled in the traditional financial centres of London, New York and Tokyo. Offshore, therefore, is not an area outside the state system, but a *juridical realm marking the differential degrees of intensity by which states apply regulation and taxation*. Offshore signals, therefore, a profound fissure in the life of the state system: it denotes nothing less than the bifurcation of the juridical space of SOVEREIGNTY into mutually dependent relative spaces.

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offshore production

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RONEN PALAN

offshore production

The term 'offshore production' refers to FOREIGN DIRECT INVESTMENT (FDI) in production facilities located outside the country of origin of the investing firm.

There are several possible scenarios in offshore production. Offshore assembly processing involves the final assembly of a finished good at an offshore site in an overseas country so as to take advantage of lower labour costs. Assembly takes place at these factories using components, parts and other semi-finished goods imported from the parent company or another subsidiary in one of the industrialized countries. Special tariff provisions that allow for taxes on the value-added, rather than the final price, of goods that have been assembled or processed in this way, usually encourage these activities (Grimwade, 1989). These arrangements fall under the category of Offshore Assembly Provisions (OAP). A prominent example of this would be the *MAQUILADORA* industry in Mexico. International firms, mainly from the United States, shipped components duty free to a plant in Mexico. Mexican workers then assembled those components and the products were re-exported to the United States. Before the NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA), duties were levied on these imports into the United States only to the extent of the value added in Mexico. The low wages of Mexican workers permitted US firms to assemble products more cheaply than would have been possible in the United States. In some cases, the *maquiladora* concept is combined with a free trade zone – such as the Caribbean Basin Countries (Daniels and Radebaugh, 1998).

Another variant of offshore production is vertical FDI. This occurs when a company locates different stages in the production of a

single product or a group of related products in different countries. It may involve backwards vertical integration (where the foreign subsidiary is producing at an earlier stage of production) or forward vertical integration (where the foreign entity is producing at a later stage of production). As will be explained later, this is viewed as part of the global competitive strategy of multinational firms.

The pace of offshore production activity has been propelled by some structural changes in the world economy. These changes have enabled MULTINATIONAL CORPORATIONS (MNCs) to take advantage of this mode of organizing production activities. First, there have been shifts in COMPARATIVE ADVANTAGE in manufacturing. Improvements in education and the low cost of labour have permitted a number of developing countries to develop strong comparative advantage in a range of highly standardized manufactured products. Multinational firms in developed countries thus have the incentive to relocate some production processes to these countries, in order to stay competitive both in their home markets and in foreign markets. Second, technical advances in product design have made it possible to split the production process into a number of separate stages, each of which could be located at different sites. Firms now have the ability to spread out production to take advantage of the comparative advantage in the developing countries. Developments in transportation have reduced the cost of moving goods and components between different centres. Advances in information technology have enabled managers to coordinate activities in different locations into an effective network. This has permitted a new international division of labour whereby multinational firms are able to relocate the more labour-intensive parts of their production processes to offshore plants in some developing countries, while maintaining the more advanced processes at home (see DIVISION OF LABOUR, INTERNATIONAL). When coupled with public policies in both developed and LESS-DEVELOPED COUNTRIES (LDCs) that, for different reasons, encourage these types of activities, these factors have significantly en-

couraged the phenomenon of offshore production (Grimwade, 1989).

The international product life cycle has been used to explain the dynamic pattern of international manufacturing practices of multinational firms. It posits that, over the product life cycle, as product characteristics change towards maturity, the location of production will shift internationally depending on the stage of the product life cycle. Dubois, Toyne and Oliff (1993) confirm this pattern in their investigation for the 1960s and 1980s. They seek to identify the major factors that influence the decisions by firms to produce offshore. First, they find that decisions about offshore production are influenced by the production process cycle and product technology. As products mature, their features become more standardized, demand becomes more predictable and competition intensifies. Under these conditions, the manufacturing imperative shifts from flexibility to cost reduction. Firms will then search for low-cost manufacturing locations. Thus, there is a positive relationship between advances in product-process maturity and the use of low-cost foreign manufacturing locations to serve markets. In the case of product technology, they find that technology-intensive products tend to be manufactured close to the location of research and development (R&D) as a result of the need to troubleshoot production processes during the product's early life. Therefore, the more technology-intensive the product, the more likely the product's manufacturing location will be separate from markets at the early stages of the product life cycle. A second factor that influences offshore production decisions within the product life cycle framework is a shorter product life cycle. The introduction of new products under this scenario makes it necessary for firms to move the production of older products to other locations in order to allow for the use of primary production capacity for the manufacture of the newer products. This is so because newer products might need more attention. Firms may also emphasize different competitive priorities that involve cost, quality, dependability and flexibility. All of these factors

influence the extent to which a firm might adopt offshore manufacturing as part of its strategy at any time.

While the product life cycle might have been an acceptable explanation of some FDI in the 1960s and 1970s, some recent studies show that the pattern of internationalization is the result of a more complex interaction between global competition and strategy. Multinational firms design a manufacturing strategy that is congruent or supportive of their competitive strategy. They must decide on the proper allocation of manufacturing resources. Decisions about offshore production are part of the global procurement strategy of multinational firms. The 'global sourcing strategy' refers to those decisions regarding which production units will serve which particular markets and how components will be procured for production (Kotabe and Swan, 1994). Firms could be engaged in regional assembly of globally procured components or they could disperse stages of the production process to low-cost regions, with final assembly taking place elsewhere. Offshore production decisions can be thought of as a mechanism for achieving some strategic or manufacturing cost-advantage, in order to protect market position on a global basis. Multinational firms could either source their components or parts internally, or outside the firm.

When international procurement of intermediate products is done from within the scattered multinational facilities of the firm, it is called 'intra-firm sourcing' (Swamidass, 1993). Two reasons are given for the use of intra-firm sourcing. One is that it might be used to overcome trade barriers resulting from government intervention. A second reason is that it is a defence against high transaction costs of external procurement arrangements. Some of these costs involve the risk and uncertainty inherent in external procurement, and the extra costs of policing agreements with potential partners. This argument is the same one used to explain the multinational enterprise (MNE). It is viewed by Dunning (1981, 1988) as an organizational mechanism by which intermediate products, which are unavailable or

offshore production

costly to produce in the host country, are efficiently acquired and used. So, as the number of MNEs grows, one would expect import sourcing and offshore production to grow as well. Studies by Kotabe (1990) show that the extent of US firms' offshore sourcing and their global market-share are positively related, and the relationship became stronger from the late 1970s to the early 1980s.

There is some controversy regarding the effects of offshore production on home-country employment. Some argue that offshore production reduces home-country employment by moving production facilities elsewhere. Several arguments are used against this assertion. In one case, it is argued that offshore production, by freeing up home-country resources to concentrate on activities where the home country has a comparative advantage, might actually stimulate growth. This is an efficiency argument. A second argument involves the long-run competitive position of firms. Should firms be prohibited from making offshore investment decisions while international competitors reap the benefits of low-cost production locations, the long-run effects on the firms and employment might actually be worse than the short-term adjustment problems associated with offshore production. An additional point that is raised in support of offshore production is the windfall to consumers that comes when the price of a particular product falls as a result of offshore production (Hill, 1999). In the final analysis, the employment effects of offshore production would seem to be an issue that could only be resolved by empirical investigation.

Criticisms of some offshore production arrangements (such as the *maquiladora*) are based on their impact on the host country. First, there are charges of environmental degradation as a result of the *maquiladora* process. This is especially true when firms from the United States are able to exploit differences in environmental regulation (and the enforcement of those regulations) between the United States and Mexico. The economic impact of such offshore production facilities on the host country's population is also debatable: they are often seen

as enclaves of foreign firms that produce goods mostly for export and pay low wages, so local consumers do not benefit from those activities (Daniels and Radebaugh, 1998).

See also:

multinational enterprise (MNE), structures and strategies of

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ALFRED N. NTOKO

Oleron, laws of

The laws of Oleron were one of the earliest examples of an internationally recognized code to regulate aspects of international commerce within the emergent Western states' system and, thereby, the basis of an early form of informal international regime. The 'laws' defined the rights and responsibilities of the captains of ships when sailing the open seas and encompassed duties regarding pilotage, the carrying of cargo, and the control and reporting of sickness on board. They also gave ships' captains rights regarding the discipline, mutiny and pay of their crews. The laws, which were probably based on the earlier Mediterranean code of the Rhodian law, were enacted by Eleanor of Aquitaine (later the wife of Henry II of England) but attributed to the Island of Oleron, which formed part of the Duchy of Aquitaine.

The laws of Oleron were later introduced into England by Eleanor's son, Richard I. They subsequently formed the basis of the English Black Book of the Admiralty (1336).

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R.J. BARRY JONES

OLERON, ROLLS OF *see* Oleron, laws of

oligopolistic competition

The word OLIGOPOLY derives from the Greek roots *oligoi* ('few') and *polein* ('to sell'). It is these two characteristics of oligopoly that give rise to the interdependence between firms which distinguishes this market structure from others. In its pure form, a MONOPOLY consists of a single firm, while under PERFECT COMPE-

TITION the market contains so many firms that the influence of any one on the others is negligible. By contrast, because in oligopolies there are few sellers, the profits obtained by any firm will necessarily both affect and be affected by those of the other firms in the market. This phenomenon, known as 'structural interdependence', is a unique and typical feature of oligopolistic environments. The nature and extent of individual firms' recognition of their structural interdependence is reflected in their behaviour, and such behaviour (with respect to both actual and potential competitors) will often take the form of STRATEGIC INTERACTION. Since, however, there is effectively no limit to the variety of behaviour (and strategies) that oligopolists might evince as a practical response to the peculiar character of their environment, the outcome to oligopolistic competition (in contrast to that which occurs under either monopoly or perfect competition) cannot be anticipated with certainty. The resulting indeterminacy is sometimes referred to as the 'oligopoly problem'.

In order to render tractable the analysis of oligopoly, economists have identified two broad categories of behavioural interdependence. The first is termed 'non-cooperative'. Here, each firm acts to maximize some private objective (usually profits) given what it takes to be the likely behaviour of its competitors. In pursuing its objective, a firm will typically choose either output or price as its principal strategic variable. Whatever the choice, the outcome to such competition is a non-cooperative equilibrium – a state from which no individual firm would find it profitable to depart unilaterally. Thus, in such an equilibrium, each firm is maximizing its objective given the strategies being played by its rivals. The equilibrium associated with competition in output is termed a 'Cournot equilibrium' and that associated with competition in price is termed a 'Bertrand equilibrium', after the two nineteenth-century economists who originally identified the respective properties of these outcomes. In general, Cournot equilibria are characterized by higher prices (and profits) and smaller total output than are Bertrand

oligopoly

equilibria. The study of the processes whereby such equilibria are attained, as well as their properties of uniqueness and stability, has long been the focus of economists' attention, and increasingly also that of mathematicians with an interest in GAME THEORY.

The second category of oligopolistic behaviour is termed 'cooperative'. In this case, firms are able to make binding commitments to maximize a common objective (usually joint profits), as they do in CARTELS. While the pursuit of private objectives yields outcomes which, by definition, are maximally profitable for each firm given non-cooperative behaviour on the part of its rivals, both individual and group profits can almost always be increased by universal cooperation. The danger, where such cooperative undertakings are concerned, is that provided the others abide by the collective agreement, each firm will have an incentive to deviate from it so as to obtain a profit advantage for itself. In order to encourage adherence to the common objective, the group may undertake to punish any deviation by reversion to the non-cooperative equilibrium – an action that could leave the deviant worse off than it would have been if it had not deviated. The particular circumstances under which such a threat will be both credible and a deterrent have also been the subject of attention from economists and game theorists.

The nature of oligopolistic competition, and the disposition (as well as the ability) of firms to behave either non-cooperatively or cooperatively, depend in large part on the good or service that is being sold and on the opportunities that exist for PRODUCT DIFFERENTIATION. Oligopolists are, as a general rule, averse to price competition on the grounds that the impact of such behaviour is usually so destructive of competitors' profits that retaliation is inevitable. The result is that all firms emerge with relatively low profits. Where no opportunity exists for cooperation to maintain prices, and in order to diminish the incentives for what may ultimately emerge as mutually destructive price-cutting, firms may signal to their rivals their reluctance to initiate price reductions, or they may engage in non-price competition such as product

differentiation, ADVERTISING, coupons, tying of customers and the like. The impact of such competition on the profits of rivals is usually less direct than that of price-cutting and is therefore less likely to invite a response. In view of the awareness on the part of firms of the impact of their actions on rivals, there is a tendency (even in the absence of cooperative agreements) for prices in oligopolistic markets to exceed those that would be achieved under more overtly competitive conditions; there is also a tendency for these prices to be stable for relatively long periods of time, often in the face of increases in both costs and market demand.

Oligopolists compete not only with existing rivals, but also with potential entrants into their markets. The principal strategic variables when dealing with the latter are, again, product differentiation and advertising, as well as PRE-EMPTIVE INVESTMENT in productive capacity in order to signal to prospective entrants a willingness and commitment to resisting market encroachment. The erection of such barriers to entry is an integral part of the strategic behaviour of oligopolists and accounts to a large degree for the stability of the composition of the firms in such markets. Given the extent to which these barriers may deter new competition and thus prevent the erosion of existing firms' profits, it has been argued that the proper role of government in this arena is to eliminate as far as is possible the legal and other impedimenta to both entry and exit that may be faced by prospective entrants. In this way, market entry will be facilitated, with the result that incumbent firms will be discouraged from seeking the excessive profits which render such entry attractive.

See also:

monopolistic competition

R. ROTHSCHILD

oligopoly

Oligopoly is a situation or market structure where there is a high degree of INTERDEPEN-

DENCE between a few rival firms that dominate an industry. Each firm's policy decisions need to allow for its rival's reactions. The actions of each firm significantly affect the profits and market share of the other firms. Hence they have reason to watch each other's behaviour very carefully and allow for the reactions of rivals when deciding on prices, advertising and investment. A price-cut by one firm may be copied by other firms so as to stop the first firm from gaining market share, with the result that the profits of all the firms fall substantially. There is thus an incentive to cooperate in maintaining prices, if agreement can be reached, thereby exerting MARKET POWER, reducing uncertainty and raising profits. This incentive is much greater when the number of firms is small – in contrast to a situation in which there are so many firms that the actions of any one firm has little impact on the others. Cooperation requires communication and a measure of TRUST, which may be difficult to achieve given the temptation to free ride on the efforts of others (see FREE RIDER PROBLEM).

Many industries are dominated by a small number of firms. Periods of cooperation have alternated with price wars. In the case of the base chemical industry, there have been CARTELS which have contravened EUROPEAN UNION (EU) rules on competition, resulting in fines on the firms involved – mainly MULTINATIONAL CORPORATIONS (MNCs). In the United States, anti-trust policy is directed against anti-competitive behaviour by oligopolistic firms. They are sometimes called MONOPOLIES, even though they do not have a complete monopoly on the supply of a product category. Since oligopoly can create uncertainty, instability, lower EFFICIENCY and (when there is collaboration) EXPLOITATION of consumers, there is a case for government regulation. Some attempts to model oligopoly have used GAME THEORY.

It is of the essence of oligopoly that there is substantial interdependence between the suppliers. The policy of one firm impacts on the effectiveness of the policies of other firms. Because of this feature, students of relations between states have seen parallels with oligo-

poly: for example, if one state subsidizes its exports to gain competitiveness, will other states do the same? Do leading states cooperate in such policy areas? Sometimes a big firm plays a leadership role in setting prices, with other firms following its example. Does one state have a comparable position? As the number of firms or states rises, does cooperation weaken and free-riding increase? An example of this latter case, from the 1980s, was the growth in the number of sizeable suppliers in the oligopolistic oil industry, while cooperation weakened between the members of the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC).

See also:

duopoly; oligopolistic competition

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DAVID LAW

oligopsony

Oligopsony in a market/area is when there are only a few buyers. If there are many sellers, then the buyers may have some MARKET POWER over them, enabling the buyers to bargain for lower prices or wages. An example is (immobile) workers in an area where there are few large employers.

See also:

bargaining; advantageous factors; monopsony; oligopoly

DAVID LAW

Olson, Mancur (1932–98)

Mancur Olson was born in Grand Forks, North Dakota, educated at North Dakota State University, Oxford (as a Rhodes Scholar) and, in 1963, received a Ph.D. from Harvard. He was assistant professor at Princeton from 1963–7 and then worked at the Department of Health, Education and Welfare for two years, where he helped write *Towards a Social Report* (1969), which was the first government effort to move beyond the national income accounts to a broader social accounting. After leaving government, Olson returned to academic work at the University of Maryland, where he spent the rest of his career until his untimely death on 19 February 1998. At Maryland, he was Distinguished University Professor of Economics and Principal Investigator of the Center for Institutional Reform and the Informal Sector (IRIS).

Olson is recognized as one of a handful of scholars responsible for changing the field of economics to ensure that politics became an integral part of economic thinking and policy formation. His work emphasized the fact that a country's economic policies and the quality of its legal institutions primarily determine its economic performance.

Two books by Olson – *The Logic of Collective Action* (1965) and *The Rise and Decline of Nations* (1982) – are considered seminal works in economics and political science. At the time of his death, Olson's research was extending his analysis of the origins of government provision of public goods, the fiscal policies of democracies and autocracies, and the role of property and contract rights in economic development.

The basic premise of *The Logic of Collective Action* is that there are many situations in which individuals will benefit from a particular course of action only if all the individuals with whom they interact agree to it. In the absence of such consensus, Olson noted, particular individuals may benefit from ignoring that consensus, although their violation of it may impose costs on everyone else. For example, all

drivers will benefit if every one of them obeys the speed limit. At a minimum, there will be fewer accidents. But a particular individual may perhaps benefit through getting to their destination more quickly by exceeding the speed limit. And because the logic of the group and the logic of the individual can point in very different directions, Olson suggested that one of the most important tasks of public policy is to formulate a system in which individuals can agree and thus achieve mutual benefits.

When will rational, self-interested individuals not act to achieve their common or group interests? Olson distinguishes situations where the collectively rational outcome emerges automatically from those where it does not. Individuals acting independently in markets may not achieve an improved outcome when the good in question is such that if it is available to one person it is available to others. Olson calls these COLLECTIVE GOODS. If someone provides the good, others know they can benefit without helping to provide the good. When the group of potential beneficiaries is large, Olson predicts that the good will not be provided unless there is coercion or selective incentives.

Olson's framework extends the neo-classical insight that while each firm would benefit from reduced output, in competitive markets it pays no-one to reduce output. As firms try to maximize profit, the price drops to cost and the collective interest of some group of producers is lost to consumers.

Just as it was not rational for a particular producer to restrict his output in order that there might be a higher price for the product of his industry.

(Olson, 1965: 11)

Olson insists that individuals in markets are no different from individuals forming interest groups. Further, he contends that 'there is no propensity to form joint associations' (ibid.: 17).

The main assumptions of Olson's framework are that: (1) group size matters, (2) asymmetry of individual valuation of the good matters, (3) the ability to coerce and offer selective incentives matter, and (4) many groups will

remain latent, unserved and silent. The core of Olson's analysis is the proposition that the likelihood of the collective good's provision is a function of the group size: 'The larger the group the farther it will fall short of providing an optimal amount of a collective good' (ibid.: 35). And this turns essentially on how the character of the collective good affects the calculation of an individual. Individuals have to perceive how their actions affect the provision of a good. In large groups, individuals will not see the effect of their own contributions to the good's existence.

Olson distinguishes three categories of groups: (1) privileged, (2) intermediate and (3) latent. In Olson's framework, the privileged group has a member whose individual benefit from some amount of the good exceeds the total cost of its provision. Olson assumes that this person will act to provide the good regardless of the lack of participation by other beneficiaries. The intermediate group does not have one member with individual net benefits, but there is some relatively small group whose members can see the effect of their own non-participation. The outcome of this realization is indeterminate and subject to strategic action, but it is presumed here is a chance of success. On the other hand, if the 'latent group' is large and likely not to contain any one member, or subset, that can see the effect of their own non-contribution, then (as Olson puts it):

an individual in a 'latent' group, by definition cannot make a noticeable contribution to any group effort, and since no one in the group will react if he makes no contribution, he has no incentive to contribute.

(ibid.: 50)

Occasionally large federated groups comprising small cells of socially interactive members may provide collective goods. In general, then, Olson argues that as the size of the group increases, any individual's share of the total benefit becomes smaller and therefore is likely to be less than cost.

Several of Olson's findings have important policy implications. 'Where small groups with common interests are concerned then, there is a

systematic tendency for "exploitation" of the great by the small' (ibid.: 29). The individual or small group with benefits exceeding cost may provide all of the good that is wanted by people with more modest demands. Olson assumes that a person who stands to gain a great deal from going it alone will supply the good even if there are many free riders (see FREE RIDER PROBLEM). This is the neo-classical assumption that, since people prefer more to less, they will always act consistently with the principle of value-maximization. In an extension of this analysis to the theory of alliances, Olson and Zeckhauser (1966) find that the larger members with more to lose in the NORTH ATLANTIC TREATY ORGANIZATION (NATO) alliance contribute more per capita than the smaller and poorer nations.

A number of interesting issues emerge from Olson's analysis. What are the options available to the latent group? Olson argues that their only options are selective incentives and coercion. He uses the case of labour unions to illustrate the role of coercion. The history of unions shows that they were first organized in small farms with relatively few employees, which supports Olson's thesis that small groups are more likely to provide collective goods. Clearly, small size does mean that non-participation will be noted. Olson offers further proof of the role of compulsion by reference to the 1935 Wagner Act, which required employers to bargain collectively if a majority of workers voted for a union. Here, Olson's main point is that the compulsion of the closed shop was highly desired by unions and contributed to their success. Other examples of compulsion are noted in the provision of collective goods: for example, various professional associations including medicine and law act to limit practice to those who support the associations.

Political pressure groups generally provide a good that, if available to one person, is available to others in the same general category (such as farmers, environmentalists or manufacturers). Olson's survey of the characteristics of large groups that are successful in providing collective goods identified those who also provide low-exclusion cost-effective goods.

Thus successful pressure groups offer a by-product and mobilize a latent group with 'selective incentives often in combination with some form of compulsion' (ibid.: 133). Olson argues that the main types of large economic lobbies – the labour unions, the farm organizations and the professional organizations – obtain their support mainly because they perform some function besides lobbying (ibid.: 135). The Farm Bureau sells insurance and farm supplies; the American Medical Association sells advertising in its journal and uses the profits for lobbying.

The case of business lobbies is used by Olson to reinforce his model and to show what happens when lobbies cannot utilize by-products.

The high degree of organization of business interests, and the power of these business interests, must be due in large part to the fact that the business community is driven into a series of (generally oligopolistic) industries, each of which contains only a fairly small number of firms.

(ibid.: 143 4)

He observes that the most successful business lobbies are for industries with a small number of firms that thus constitute privileged or intermediate groups. He quotes a study finding that of 421 trade associations in the metal products industry, 153 have a membership of less than twenty and the median is between twenty-four and fifty (ibid.: 144). He calls this his 'special interest theory', where 'special interest' is a variety of small.

To summarize, in *The Logic of Collective Action* Olson used the economist's basic behavioural assumption of individuals maximizing self-interest and asked what kind of groups will evolve. He found that small groups would exist where the benefits to the individual of group action would exceed their costs or where individuals could be coerced into action, and that large groups (for example, the American Medical Association and trade unions) would exist where their members could receive exclusive individual benefits not available to outsiders. He also demonstrated that

when large groups were organized to create change, but did not possess some exclusive benefits for members, they tended to be unstable and disappear. In essence, rational individuals will not incur the costs of participating in large group action when benefits can still be received by being a free rider. Olson's approach has had a major impact on thinking in the social sciences, so much so, indeed, that the very term 'free rider' has become a basic part of the vocabulary of social scientists. Like a lot of PUBLIC CHOICE (PC) THEORY, Olson's points seemed obvious once he had made them. But somehow they had been neglected until he came along.

Olson went on to apply this approach in his 1982 book, *The Rise and Decline of Nations*. Interest in the process of economic development even predates the 1776 publication by ADAM SMITH of *An Inquiry into the Nature and Causes of the Wealth of Nations*. Unfortunately, the search for a recipe for growth has often overlooked some important ingredients. In older models of economic growth, physical resources were the focus. In these formulations, output flowed from combinations of various inputs (land, labour and capital). In principle, then, it seemed logical to conclude that faster growth would result from infusions of additional inputs (chiefly capital) or better use of existing inputs (often thought to require centralized economic planning). In practice, however, such prescriptions have often been disastrous for LESS-DEVELOPED COUNTRIES (LDCs). Newer (endogenous growth) models have identified many other variables that contribute to differences in growth rates – for example, knowledge spill-overs resulting from increases in the stock of physical capital, technology transfers and human capital investment (see ENDOGENOUS GROWTH THEORY). Yet even these sophisticated formulations often fail to explain observed patterns of DEVELOPMENT.

To overcome this limitation, Olson focused attention on the nature of institutions and on the structure of rules and norms that constrain economic behaviour, as a way of understanding the development process. Olson would not deny that abundant natural resources, a highly

skilled labour force and ready availability of new technologies might enhance growth, but to him factors are neither necessary nor sufficient conditions for growth. If resource endowments determined a national economy's fate, Venezuela would be rich and Taiwan poor – and South Korea would be as destitute as North Korea. East Germany's highly skilled labour force should have enabled it to keep pace with West Germany before the collapse of the Iron Curtain. And if access to sophisticated technology guaranteed prosperity, perhaps the Soviet Union would still exist.

Olson started his analysis of growth with a series of observations about European economies after World War II and noticed the obvious. Countries badly damaged by World War II, notably Germany, thrived after the war, while the United Kingdom (presumably a victor) did not. His theory was that in stable nations special-interest groups grow like car-buncles on the national economy, gradually weighing it down with inefficiencies, subsidies and sinecures. In countries like Germany, by contrast, the trauma of defeat had obliterated all the special arrangements – Olson called them 'distributional coalitions'. Unencumbered, these countries could adopt new technologies more quickly, allocate resources more efficiently and govern more effectively. His basic message is straightforward: when these distributional coalitions are destroyed, economies will grow rapidly. It is worth summarizing the basic implications of *The Rise and Decline of Nations* in Olson's own words:

- 1 There will be no countries that attain symmetrical organization of all groups with a common interest and thereby attain optimal outcomes through comprehensive bargaining.
- 2 Stable societies with unchanged boundaries tend to accumulate more collusions and organizations for collective action over time.
- 3 Members of 'small' groups have disproportionate organizational power for collective action, and this disproportion diminishes but does not disappear over time in stable societies.

- 4 On balance, special-interest organizations and collusions reduce efficiency and aggregate income in the societies where they operate; they make political life more divisive.
- 5 Encompassing organizations have some incentive to make the society in which they operate more prosperous, and an incentive to redistribute income to their members with as little excess burden as possible and to cease such redistribution unless the amount redistributed is substantial in relation to the social cost of the redistribution.
- 6 Distributional coalitions make decisions more slowly than the individuals and firms of which they are comprised; they tend to have crowded agendas and bargaining tables, and more often fix prices than quantities.
- 7 Distributional coalitions slow down a society's capacity to adopt new technologies and to reallocate resources in response to changing conditions, and they thereby reduce the rate of economic growth.
- 8 Distributional coalitions, once big enough to succeed, are exclusive and seek to limit the diversity of incomes and values of their membership.
- 9 The accumulation of distributional coalitions increases the complexity of regulation, the role of government and the complexity of understandings, and it changes the direction of social evolution.

(Olson, 1982: chap. 3)

Olson applies this theoretical framework to a broad range of historical cases. He maintains that it explains the rapid post-war revival of West Germany and Japan, as well as the growth of Hong Kong, Korea, Singapore and Taiwan; the slow growth of the United Kingdom in the 1970s, and the relative growth rates of different regions of the United States, as well as the overall rapid growth of the US economy in the nineteenth century. Furthermore, Olson argues, it helps to account for the emergence of Britain, France and Holland in the early modern period; to explain the decline of old cities in the midst of expanding countries, and

to account for the stagnation of India and China in the nineteenth century.

Finally, in a chapter of sweeping implications, Olson shows that his approach provides unique insights into the development of unemployment and STAGFLATION. Here, all of the standard theories of stagflation, unemployment and BUSINESS CYCLES are found wanting by Olson. They lack a firm grounding in the individual maximizing behaviour of micro-theory. The attention paid by J.M. KEYNES to sticky prices was well placed, but their sources were not explained. In the neo-classical tradition, Olson believes that all would be well if markets were cleared. So he asks: what prevents mutually advantageous labour exchange from happening and who has an interest in blocking it? The now familiar answer from Olson's logic is that privileged interest groups with high wages form coalitions to prevent the employment of those who would willingly work for less.

He concludes that the Keynesian policy of increasing aggregate demand (see KEYNESIAN ECONOMICS) can help offset the effects of special interests, but is only a second best solution. The best policy is to remove barriers to market clearing. Here, he advocates a tax on employers who raise wages above productivity. In addition, Olson would like the government to

repeal all special interest legislation or REGULATION and at the same time apply rigorous anti-trust laws to every type of cartel or collusion that used its power to obtain prices or wages above competitive levels.

(ibid.: 236)

In sum, Olson's contribution is to show the consequences of the interest-group pressures that have evolved in the modern Western world. It should be noted, however, that he is not merely saying that the governments in stable democracies get too big over time. He noted that the post-war German and French governments were not necessarily less intrusive than that of the United Kingdom, and that the British decline actually began in the late nineteenth century when its government was

quite small. Distributional coalitions can afflict private arrangements just as surely as public ones. Nor was he saying that the government that moves most decisively is the most efficient. He argued that the Swiss have maintained high growth rates because their government is so cumbersome: even special interests have trouble getting measures passed. At the end of *Rise and Decline of Nations*, Olson emphasized that he was not a pure free marketeer. He appreciated the power of markets, but he did not believe that the government that governs least, governs best:

There often will not be competitive markets even if the government does not intervene. The government is by no means the only source of coercion or social pressure in society.

(Olson. 1982: 18)

Olson acknowledges the contributions of MILTON FRIEDMAN, but also argues that recent economic history does not always support the free-market view. Some LAISSEZ-FAIRE nations achieve only low growth rates, while more dirigiste nations show higher growth rates.

Recent history certainly bolsters the Olsonian logic. The Asian nations, after a period of phenomenal growth, seem to have become hobbled by accumulated nepotism, special-interest subsidies and rigidities they allowed to build up in their economies. Western Europe has not maintained its rapid growth and now slogs along with high unemployment. The United Kingdom was stagnant until Margaret Thatcher disturbed public and private rigidities, and now that nation flourishes. In the 1990s, the US economy has thrived, perhaps because the downsizing trend of the 1980s swept rigidities away. New and youthful sectors in places like Silicon Valley are relatively unencumbered and drive economic growth.

Olson's insights are especially relevant at a time when many people have come to believe that market forces can solve all questions of the relationship between the individual and the community. And for societies undergoing the transition from communist authoritarianism to democracy and free markets, it is a useful

reminder of the kind of tasks that the market alone cannot solve. Indeed, in a market situation in which there are no constraints of any kind – no agreements on weights and measures, no quality controls and no licensing arrangements, to name but three – individuals may behave in ways that will benefit them, but only at a cost to others.

Free-market theorists argue that the market will be self-correcting, that individuals will challenge other individuals who may be exploiting others. Such a theoretical claim is not unconvincing, but it assumes more openness and transparency than is true in many market situations. More importantly, it also ignores the fact that people exist in time and space, and that the promise of redress in the future may not be sufficient to deal with problems they now confront. Groups of aggrieved individuals may turn to the political system, frequently banding together in ways that benefit all members of these groups but impose costs on others; and such activities, Olson showed, can work either in a way that will bring these various interests together into a new collective agreement or in a way that undermines the very possibility that a particular collectivity – be it a trade union, a government or even a state – could continue to exist.

Unfortunately, because his theories did not provide a neat template of exactly what would happen in any particular situation, Olson never became the kind of ideological leader that the authors of other theories have sometimes become. But there are three important reasons why his insights are likely to be more important than many of theirs over the longer term:

- 1 Olson clearly saw that individual and group decisions matter, that human beings have choices and that the choices they make will affect the future. Such a position elevates the individual and the group, and gives to both a moral stance often denied by those who see all human activity as the result of some hidden hand, be it the class struggle or the market.
- 2 Olson highlighted a key dilemma of the individual in society: individuals may benefit

if all or most of the other members of a society are prepared to follow the same rules, but they may also benefit – sometimes even more so, and more immediately – if they violate those norms themselves.

- 3 Flowing from (1) and (2), Olson saw the history of societies as open-ended, as a process in which individuals and groups would contend in ways that could lead in a variety of directions – at one point, moving towards greater freedom; at another, towards less.

For societies going through the difficult transition from communism to democracy and free markets, Olson's ideas are an important reminder of both the possibilities and the limitations inherent in any such human project. For outsiders encouraging these societies to make these changes, his theories may be even more important as a corrective to those who believe that there is any single path to these goals.

On learning of Olson's death, Yegor Gaidar (former Prime Minister of Russia) noted in a press release that

such persons as Professor Olson are, in our view, irreplaceable, and it will take some time to rightly estimate his invaluable contributions to the development of the economic sciences.

References and further reading

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ROBERT LOONEY

Omnibus Trade Act

In August 1988, after three years of intense struggle, the US Congress passed the Omnibus

Trade and Competitiveness Act and President Reagan signed it into law. The origins of the Omnibus Trade and Competitiveness Act of 1988 can be traced to a number of factors, the most immediate of which was the sharp deterioration of the US BALANCE OF TRADE beginning in the late 1970s. To some, this deterioration represented a fundamental change in the competitiveness of American goods in comparison to foreign products. Others blamed excessively high foreign barriers to US exports and inadequate US barriers to imports.

In the face of increasingly strong foreign competition, organized labour moderated its demands for higher wages and even accepted wage cuts in some important sectors. As unions called for government action, they were joined by industries suffering through the recession of the early 1980s, especially those that had been declining relative to foreign competitors over many years.

Officials of the Reagan administration, along with some congressmen, worked hard to soften the proposals to erect import barriers and to regulate international business practices. By the end of the summer of 1988, congressional negotiations had produced a bill with complex and sometimes contradictory provisions. While most politicians were not overly enthusiastic about the legislation, they did not show open opposition.

As with many large pieces of legislation, most of the 1988 act contained technical and definitional material that was important only at the margin.

1 *Trade relief*: Under the act, industries seriously injured by imports could receive some protection if they were willing to make a 'positive adjustment' to foreign competition. Firms obtaining such relief would have to agree to a five-year plan to restore their competitiveness.

2 *Worker assistance*: The act created a \$1 billion retraining programme (financed by an import fee) to help workers displaced by imports. Also, worker rights in foreign countries are one of the factors in determining unfair trade practices.

- 3 *Intellectual property*: The act has measures to enhance the protection afforded by US patents, copyrights and other intellectual (industrial) property rights. It strengthens the ability of US companies to block imports – without the need to prove damages – if patents are violated.
- 4 *Use of the metric system*: Under the act, the government is required to use the metric system of measurement in its procurement, grants and other business-related activities. However, private firms remain free to decide whether or not to convert to the metric system. The United States, Burma and Brunei are the only countries in the world that have not gone metric. The lack of metric product designs and labelling constrains US exports, amounting to a self-imposed NON-TARIFF BARRIER (NTB).
- 5 *Negotiating authority*: The act grants to the president authority to continue negotiations under the URUGUAY ROUND sponsored by the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT). Here, the intent of the United States was to open foreign markets for banking, insurance and other services; to gain protection for patents, trademarks, copyrights and other intellectual property rights; to liberalize rules pertaining to direct foreign investment, and to cut tariffs by up to 50 per cent. Furthermore, the act established a procedure – voting up or down without any amendments – to expedite the ratification by Congress of Uruguay Round agreements submitted by 1 June 1991.
- 6 *Competitiveness*: The act does little to improve US competitiveness (as usually defined). It makes mention of education reforms to increase the language and technical skills of US workers and managers, but provides only modest funding for that purpose. It calls on the National Bureau of Standards (renamed the National Institute of Standards and Technology) and other government agencies to allocate more resources to the transfer of government technology to private companies.

The controversy over the 1988 Omnibus Trade Law centred around two other provisions. One, requiring employers to comply with particular rules about notice of plant closings, was ultimately stripped from the trade law and passed separately; the other, originally referred to as the ‘Gephardt amendment’, is now known as SUPER 301. Super 301 was actually the culmination of a trend in US trade legislation that began in the early 1960s:

- 1 *Trade Expansion Act of 1962*: This act gave the president broad discretion to retaliate against ‘unjustifiable’ foreign trade barriers (with greater authority to retaliate against agricultural barriers) and also limited authority to retaliate against ‘unreasonable’ barriers. The law supplemented but did not replace Section 350 of the Tariff Act of 1930 (enacted under the Trade Agreements Act of 1934).
- 2 *Trade Act of 1974 (Sections 301–2)*: The 1974 act expanded the president’s discretionary authority to retaliate against both unjustifiable and unreasonable foreign barriers, with no distinction made between agricultural and non-agricultural goods. It replaced Section 252 of the 1962 act, extended coverage to services associated with international trade, authorized action against foreign export subsidies and required the United States Trade Representative (USTR) to submit reports to Congress every six months.
- 3 *Trade Agreements Act of 1979 (Sections 301–6)*: This act left the presidential authority unchanged. It did, however, clarify applicability of statute to services ‘whether or not associated with specific products’, established more detailed procedures for investigations (including time deadlines for action), required consultations with foreign trade partners and use of available dispute settlement procedures.
- 4 *Trade and Tariff Act of 1984 (Sections 301–7)*: While the discretionary authority of the president was unchanged, the USTR was now permitted to self-initiate investigations and recommend action to the president. The

major change from previous acts was the authorization to retaliate in the services sector. The act explicitly included, for the first time, coverage of INTELLECTUAL PROPERTY RIGHTS (IPRs) and FOREIGN DIRECT INVESTMENT (FDI), and required the submission to Congress of a National Trade Estimates report.

- 5 *Omnibus Trade and Competitiveness Act of 1988 (Sections 301–10)*: This act shifted the authority to retaliate from the president to the USTR, subject to the specific presidential direction (if any), and made retaliation against unjustifiable practices mandatory (but with many loopholes permitting considerable discretion). The major changes from the previous law were the establishment of Super 301 which required USTR in 1989–90 to identify trade priorities (including designating 'priority countries and practices' to be investigated under 301), the establishment of Special 301 to promote more aggressive assertion of IPRs and the establishment of new deadlines for action in cases involving GATT dispute settlement or intellectual property.

For most economic commentators, Super 301 was the epitome of unenlightened economic policy. Whole sessions of the GATT Council have been devoted to criticizing this provision of US trade law and nearly every conference on international trade held in the next several years debated just how bad the new provision was. Outside the United States, opinions about Super 301 ranged from the belief that it is merely a major impediment to liberal international trade to the contention that it is an absolute bar to new liberalization.

Many US politicians and businessmen generally have an equally strong, but very different, view of Super 301. They have celebrated it as the one meaningful weapon in the US arsenal for protecting US commercial interests from foreign attack – a 'crowbar' to open foreign markets to US goods and a shield against 'unfair' foreign competition. To date, neither the fears about this section nor the hopes for it (or for the act in general) have been

justified. Notwithstanding its potential, Super 301 has not played a very important role. It does, however, reflect a new political reality that may at some time significantly change US trade policy.

This political change appears to have come about as a result of congressional concerns that the trade policies of the Reagan administration were incapable of redressing the decline in US exports and the perception that other countries were not 'playing fair'. In this regard, Reagan and his appointees were viewed as particularly inattentive to important congressional supporters' concerns for their own commercial success. The combination of strong foreign policy interests and strong pro-market rhetoric gave the Reagan administration the aura of committed free-traders, although from its inception the administration's action demonstrated a willingness to protect US businesses from overly successful foreign competition. However, policy-makers on Capitol Hill demonstrated less pragmatic political compromise and more resistance to trade protection than congressional consensus would have dictated.

Although the more straightforward demands for protection were not often acted on, there was considerable congressional support for arguments that US markets should not remain open to products from countries that did not play by free-trade rules. Executive officials generally counselled that infractions of the international rules were subject to adjudication within GATT. The United States had, after all, agreed as a contracting party to follow GATT rules, including the admittedly weak and frustrating dispute-resolution process. Failure to invoke that process before imposing trade sanctions would be to risk retaliatory sanctions from other nations.

Many congressmen, however, saw the administration's references to US GATT obligations as mere cover for resistance to mercantile protection. In fact, other nations disregarded their GATT obligations – often to the disadvantage of the United States – and GATT had shown itself to be quite toothless, especially since its sanctions depend on the transgressor's consent.

The proposed new laws therefore stressed mechanisms to force executive officials to adopt measures to protect politically important commercial interests without relying on appeals to GATT. Some proposals would have expressly linked US government action to the US merchandise trade-balance. Others would have responded to specific bilateral trade-balances. All the proposals substantially reduced the scope for administrative discretion. Opposition by the Reagan administration and by sympathetic congressmen blocked these proposals.

The three related provisions that did achieve the necessary consensus, adopted a different approach involving three key elements. First, the new provisions were targeted against the behaviour of other governments in their home markets, instead of focusing on the competition provided by imports in the United States. Second, the provisions require public executive action on a specific timetable to identify the foreign miscreants ('priority' countries). Third, the provisions restricted the ambit of permissible responses, but maintain a sphere for administrative discretion both in designating the priority countries and in taking action against them.

More specifically, the USTR must publicly identify the nations that violate US open-trade norms and, having done so, must describe the course of action being taken to redress those violations. The general provision, commonly known as Super 301, is now contained in Sections 301 through to 310 of the amended Tariff Act of 1930.

Two related provisions, Section 182 (Special 301) and Sections 1,374 through to 1,380 of the Omnibus Trade and Competitiveness Act of 1988 require similar action, focused respectively on US trading partners' treatment of IPRs and telecommunications trade. Together, these Super 301 provisions constitute a 'sun-shine act' for trade policy.

The Super 301 provisions have had the intended effect of forcing the USTR to label specific trading-partner nations as unfair traders and to engage in negotiations with those nations to end the identified unfair practices.

As predicted by the advocates of Super 301, these negotiations – including the threat of being labelled as a priority country – have produced some changes in other governments' formal policies; as the critics of Super 301 predicted, US implementation of these provisions spurred nearly unanimous international condemnation and complicated negotiations in GATT's Uruguay Round – however, both effects have been quite modest.

The statutory deadline for the USTR's first list of priority nations and priority practices under Super 301 was 28 May 1989. In the months leading up to this date, several nations engaged in bilateral negotiations with the United States to avoid inclusion on the list. The United States' trading partners, most notably the Republic of Korea, agreed to a number of formal undertakings. Just before issuance of the first Super 301 list, the Korean government cut its average tariff in half, liberalized import restrictions in many different sectors and agreed to abandon a set of 'localization' rules that had frustrated importers.

Many of these changes might have occurred without the prod of Super 301, but clearly the Super 301 'naming' process accelerated some concessions and was probably a conclusive consideration in others. Despite these concessions, the United States' trading partners still impose both direct and indirect constraints on trade that violate international agreements or are otherwise 'unfair'.

As the May 1989 deadline approached, debates within the administration revealed a number of possible ways to compile the list. One was to focus on priority practices that impeded trade and to list the countries, including the United States, which engaged in these practices without targeting any nation as a priority country. Given the breadth of restrictive international practices, their widespread use and the inclusion of nearly all major trade restrictive practices on the agenda for multilateral discussion in the Uruguay Round, this approach would arguably have complied with the 1988 trade act without threatening the GATT talks. A second possibility was to include a very large number of priority

countries on the initial list, with the expectation that progress made in the Uruguay Round would allow the US trade representative, in drawing up subsequent lists, to proclaim that the countries no longer deserved priority status. Other approaches were also considered.

The serious controversy centred on Japan. Several prominent US officials pushed hard to keep Japan off the Super 301 list. They cited the low level of formal Japanese trade barriers, the large number of trade concessions the Japanese made in recent bilateral negotiations, the anticipated sensitivity of the Japanese to being named as 'unfair traders' (the Japanese explanation of priority-country status) and the special strategic relationship between Japan and the United States (including US dependence on Japanese financing to fill the gap between US savings and domestic investment). Other officials pressed equally hard to include Japan, largely on the basis of expected congressional reaction. In fact, some members of Congress publicly declared that Super 301 was written with Japan in mind and would be rewritten if Japan were not listed as a priority country. Indeed, the Omnibus Trade Act included several provisions expressing congressional concern over the long-run US trade imbalance with Japan.

In the end, a compromise was reached. The Super 301 list designated India and Brazil as priority countries. Although it also included Japan, concern with Japanese trading policies was confined to three specific areas: telecommunications, satellites and forest products. Reaction to the list was predictable. Most US politicians declared the list a good start on the Super 301 process, but noted that they would be watching carefully to assure vigorous follow-up by the USTR. The list was seen in the rest of the world as a political statement signalling a compromise between the administration's domestic and international concerns. As might be imagined, the world's trading nations almost in unison sharply denounced the US action. Japan expressed outrage that the United States would treat so close a friend as if it were a dangerous enemy, and India complained that the United States was simply

acting as a bully. Critics uniformly stated that by carrying forward the Super 301 process, the USTR had jeopardized the Uruguay Round.

The USTR noted that the Super 301 process in no way represented unilateral action. After all, naming countries to the priority list was simply the precursor to negotiating with those countries. The countries named, however, showed little enthusiasm for negotiating at the point of the Super 301 gun. That said, the public furore over Super 301 was not matched by similar difficulties at the operational level. Although India, in fact, refused to enter bilateral discussions, it did not withdraw from the multilateral talks. The various working groups in Geneva continued to undertake their appointed Uruguay Round talks and successfully negotiated a new treaty, establishing the WORLD TRADE ORGANIZATION (WTO).

Evaluating the Omnibus Trade and Competitiveness Act is difficult, since a good counterfactual of what might have happened in its absence is hard to construct. Clearly the act did not contribute much to the US balance-of-payments position, but anyone with the slightest familiarity with macro-economics would have known this from the start – the imbalances simply reflected the country's low saving rates and high fiscal deficits, and trade practices contributed little one way or another to the external imbalances. Probably the act's greatest effect was symbolic. It signalled a change in the tone of US trade law. Before 1988, numerous official actions (both legislative and executive) had shown US trade law to be something other than a bold commitment to FREE TRADE. Indeed, US history reveals strong support both for more open rules and for tailoring trade rules to protect some US producers' interests against others and against consumers' interests. The dominant theme of US trade law over the past fifty years, however, is a commitment to open trade. Despite all the constraints imposed on agricultural trade, textiles, sugar and steel, and despite the peculiarly American reluctance to embrace strong international structures for governing trade, the dominant emphasis was on reducing barriers to trade. Modifications of basic US

law during the 1950s, 1960s and 1970s generally provided greater openness to trade, not less, with protectionist measures (such as the MULTI-FIBRE ARRANGEMENT (MFA) or the steel 'trigger-price' programme) being exceptional departures from the norm.

The 1988 act does not so much change the law as mark a different preference for its ultimate direction. The act does not direct the USTR to declare any nation's actions unfair or, having done so, to respond with particular penalties, but it clearly puts on the USTR the burden of proof that it is doing enough to combat unfair trade practices. The act does not command trade sanctions against Japan, but expresses Congress' sense that Japan has not played fairly and that it deserves to be made to pay a price if it will not play by US rules. The act does not effectively change the decisional core of trade adjudications on DUMPING or SUBSIDIES or escape-clause actions, but it announces congressional interest in strengthening those mechanisms to protect domestic industry.

From one perspective, the change in tone is puzzling. Of course, the United States in 1988 (and today) continued to run large merchandise trade deficits and several important industries were (and are) facing a long-term contraction in response to changes in international competition and consumers' tastes. But the 1988 trade act also was adopted when almost all US major trading partners were liberalizing their trade rules (making it easier to sell US exports) and when US productivity gains in manufacturing were running ahead of all the countries in the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) except Japan.

The act's tone, however, accurately reflects its time. It is one of apprehension for the future. It is a challenge to the executive branch and to US trading partners to satisfy the act's supporters that changes in the global economy will not harm the sectors of US enterprise most vulnerable to those changes. In the final analysis, the act has resulted in little other than creating bad feeling towards the United States.

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ROBERT LOONEY

open economy

An open economy is one that is engaged in foreign trade. International trade flows comprise not only goods but, to an increasing extent, also traded services. Bankers, product designers, accountants, consultants and so on, sell a considerable part of their output to residents of foreign countries.

An economy is said to be more open the larger its exports and imports are relative to GROSS DOMESTIC PRODUCT (GDP). Small countries tend to be more open than large countries. Exports account for over 50 per cent of GDP in a small open economy (such as the Netherlands); in a large country (such as the United States), however, exports account for just over 10 per cent of GDP. Since exports constitute such an important spending category in small open economies, this type of economy is more dependent on international trade than larger and more closed economies. When the growth of world trade slows down, small open economies will immediately face the consequences because their exports (and thus aggregate demand) will also slow down, causing severe macro-economic problems.

Exports depend on spending decisions made by foreign households. Therefore they are autonomous (or exogenous) expenditure from the point of view of the exporting country.

opium wars

Imports depend on spending decisions made by domestic households and are, therefore, endogenous from the viewpoint of the importing country. All categories of expenditure have some import content. As a result, imports will rise when other spending categories increase. In open economies, this may give rise to BALANCE OF PAYMENTS problems, because in this type of economy imports are high relative to GDP.

M. PETER VAN DER HOEK

opium wars

The term 'opium wars' refers to the period of Anglo-Chinese conflict between 1839 and 1860. This period of unrest was punctuated by two outbreaks of armed conflict. The First Opium War was sparked off by the detention of a number of (mostly British) traders and the confiscation of more than 20,000 cases of opium in March 1839, and ended with the signing of the Treaty of Nanking in 1842. The Second Opium War (or Arrow War) followed the detention of a British registered boat and ended with the signing of the Treaty of Tientsin in 1860, following an advance on Beijing by a British military expedition. These two treaties provided for the lifting of restrictions on trade between China and Britain, the cession of the island of Hong Kong, granting of extraterritoriality for foreign citizens (allowing British citizens accused of crimes in China to be tried by British courts) and the payment of indemnities by the Chinese government for the cost of the wars and for the impounded opium. Neither treaty mentions the opium trade, though it was legalized in China shortly after the Treaty of Tientsin.

Although this period of conflict is usually described as the 'opium wars', historians have disputed the causes. Three main interpretations have been advanced. Some have described the wars as a clash between a rising and a declining civilization. In such accounts, opium is the outward manifestation of a much deeper conflict and misunderstanding between two civilizations. Such accounts stress the misper-

ceptions between the two countries and the Chinese unwillingness to treat British representatives as equals. Neo-Marxist interpretations depict the conflict as an imperialist exercise to 'open' China to foreign trade, in order to provide a market for European manufactured goods (see NEO-MARXISM). These accounts stress the limitations placed on the foreign traders (the 'Canton System') and the pressure on Europe and the United States to find a market for manufactured goods. Once again, these writers see opium as a justification for the conflict rather than its cause. A third group of writers concentrate on the significance of opium. They stress the profitability of the opium trade: the revenue from the selling of opium provided enormous support for the administration of India. It was also the only good that it was possible to import into China that could generate enough currency to pay for the enormous export of Chinese tea – a tremendous source of tax revenue for the British government.

The Treaties of Nanking and Tientsin opened the way for the imposition of a number of 'unequal treaties' that granted trading and residential rights to the citizens of a number of foreign powers, and the reduction of China to neo-colonial status. Many historians trace the origins of the upheavals in China of the twentieth century (in particular the overthrow of the Ch'ing dynasty) to the 'opium wars'.

See also:

colonialism; imperialism; neo-colonialism

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STEPHEN HOBDEN

optimal currency area

The theory of optimal currency areas was pioneered by Robert Mundell and is a fundamental notion in the economics of monetary integration. The theory focuses attention on the costs and benefits of forming a monetary union. Costs arise largely as a result of the loss of monetary policy as an instrument of adjustment. The main concerns here lie in whether the costs for the individual member-country of losing this instrument outweigh the economic benefits of participating in the monetary union. If the economic benefits exceed the economic costs, then the countries taking part in the monetary union are said to be within an 'optimal currency area'.

When a monetary union (with a single currency and a central monetary authority) is formed, the central bank of that union has control over the monetary policy instrument for the union as a whole; national monetary authorities cannot conduct their own monetary policy operations. They thus, for example, can no longer devalue their currency in order to improve their competitiveness. They have lost that instrument of adjustment. Whether or not this situation is beneficial for the countries in a monetary union, depends on whether member-countries are equally vulnerable to the effect of any given economic 'shock'. Thereafter, the possible costs of monetary union depend on three distinct considerations. First, there is the issue of labour mobility. If countries within a monetary union have mobile labour forces, which find it easy to move between countries in response to changes in demand, then losing the instrument of EXCHANGE RATE adjustment will be less costly. Labour can move in order to equilibrate the BALANCE OF PAYMENTS positions between countries. The second consideration is with respect to wage flexibility. If wages do not move easily (particularly if they are 'sticky' in a downwards direction), then countries in a monetary union will find that it is more difficult to adjust to changes in demand than other countries who have maintained their national monetary authorities. The latter can

adjust their currencies in order to bring the forces of supply and demand into balance once more. Finally, there is the consideration of whether or not FISCAL POLICY can be used as an alternative to monetary policy (see MONETARY POLICIES) when instituting macro-economic adjustments. This is, in turn, dependent on how willing a country is to trade INFLATION off against unemployment.

On the other hand, there are benefits to joining a monetary union. First, joining a monetary union will lead to an increase in efficiency because financial transactions between the member-countries will be simpler. Second, there are gains to be made arising from the fact that financial risk will be eliminated. Because a single currency exists there is no longer the need for individuals or states to take part in ARBITRAGE activities in order to secure the highest gain from currency conversion. Finally, joining a monetary union allows the member-countries to re-establish control over their own monetary conditions. The members of a monetary union may be more insulated from international exchange rate conditions than other states manage to be.

See also:

convertibility, currency; devaluation, currency; Economic and Monetary Union (EMU); foreign exchange; interest rates

ALISON M.S. WATSON

optimal tariff

Mainstream NEO-CLASSICAL ECONOMICS has been associated with the case for FREE TRADE as a way of maximizing both world and national economic welfare. However, from the viewpoint of national welfare, some exceptions have been admitted, one of which is the optimal tariff argument. TARIFFS – at a certain level – may be the optimal (best) TRADE POLICY for some large countries when 'economic welfare' is defined narrowly in terms of consumption. This is because their economic

options, financial

size enables them to exert MARKET POWER over smaller countries. A large country may be such a large market/buyer in the world economy as to have some MONOPSONY power over suppliers that are relatively small and numerous. The supplier countries and their firms, when faced with a tariff imposed by the large country or trading bloc, may absorb most of the tariff by cutting prices so as to maintain sales and market-share. The large country gains from cheaper imports: hence better TERMS OF TRADE. In the last three decades of the twentieth century, the most plausible candidates for having had this kind of market power were the United States and the EUROPEAN UNION (EU). The case for forming a TRADE BLOC may be strengthened by the optimal tariff argument. NON-TARIFF BARRIERS (NTBs) are less likely to squeeze lower prices from suppliers than tariffs; indeed, they may raise import prices – through, for example, VOLUNTARY EXPORT RESTRAINTS (VERs). While a tariff may be the best way to squeeze supplier countries, the optimal tariff rate may be quite low given limits to the ability and willingness of suppliers to absorb the tariff. If the quantity of imports contracts, there is a loss to be set against more favourable terms of trade. Furthermore, other countries may retaliate by raising their tariffs.

The optimal tariff argument (as originally developed) did not allow for tariff-jumping FOREIGN DIRECT INVESTMENT (FDI) by MULTINATIONAL CORPORATIONS (MNCs). Very large markets can have an extra optimal-tariff type of power with regard to attracting inward investment, perhaps obtaining better terms of investment or a bigger share of world investment, which can result in investment diversion as well as investment creation (analogous to TRADE CREATION AND TRADE DIVERSION). This strengthens the case for forming or joining a trade bloc.

One implication of the optimal tariff argument is that a large country, even a hegemonic one (see HEGEMONIC STABILITY THEORY), will not favour complete free trade and especially not a unilateral elimination of its tariffs, since then it is not exploiting its market power. If a leading country does adopt free trade (Britain

in the nineteenth century is a debated case), then an adequate political economy of trade would need to explain why.

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DAVID LAW

options, financial

An 'option' is a contract giving the right to buy or sell a commodity or financial asset at a particular 'exercise' price by a particular expiry date. Options, which were first made tradable at the Chicago Board of Options in 1973, have exploded in quantity and diversity. Options are now available for stocks, BONDS, currencies, INTEREST RATES, FUTURES and many other instruments. Options can serve as a form of insurance against adverse price movements and can also be attractive to speculators because their price moves much more dramatically than does the underlying asset.

TONY PORTER

Orderly Marketing Agreements (OMAs)

An Orderly Marketing Agreement or Arrangement (OMA) is a formal international compact negotiated between two or more governments in which the trading partners agree to restrain the growth of trade in specific 'sensitive products'. OMAs are intended to ensure that future increases in trade will not disrupt or impair competitive industries or their workers in importing countries. OMAs are, in other words, formalized VOLUNTARY EXPORT RESTRAINTS (VERs) or export QUOTAS.

Japan's trade with both the EUROPEAN UNION (EU) and the United States, in particular, has been subjected to a vast array of VERs, including OMAs. Throughout the 1980s, Japan ran persistent TRADE SURPLUSES with the United States that ran into tens of billions of dollars. Many within the US government believed that this was a result not of superior competitiveness, but of unfair practices and a government-business alliance that resulted in a trading relationship detrimental to the commercial interests of the United States. As a result, the United States acted increasingly on a unilateral front to aggressively resolve such trade issues. This culminated in 1988 with the OMNIBUS TRADE ACT, which gave the US president the power to retaliate against specific foreign trade barriers.

Although a restriction on trade, OMAs were permitted under Article XIX of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) (1947), and continue to be permitted by the WORLD TRADE ORGANIZATION (WTO) if a member can show that an increase in the imports of the product 'protected' is causing, or is likely to cause, serious injury to the industry. Nonetheless, the URUGUAY ROUND Agreement on Safeguards (1992) provided for the termination of such agreements not later than eight years after the date on which they were first applied or by the end of 1999, whichever came later. The most famous OMA is the MULTI-FIBRE ARRANGEMENT (MFA), which restricts the exports of textiles and apparel; it originated in the 1960s as a VER negotiated between the United States, Japan and Hong Kong to protect US producers from cheap foreign imports.

JASON P. ABBOTT

Organisation for Economic Co-operation and Development (OECD)

The Organisation for Economic Co-operation and Development (OECD) is a forum for

economic policy COOPERATION between the advanced economies. Created in 1961, the OECD is the successor to the Organisation for European Economic Co-operation (OEEC), which had been created in 1948 to manage the initial phases of the European Recovery Program (ERP; see MARSHALL PLAN). The OEEC promoted European integration through a code for trade liberalization and the credit facilities of the EUROPEAN PAYMENTS UNION (EPU). It also promoted economic cooperation in many other domains and housed the European Productivity Agency. The collapse of the OEEC late in 1958 was precipitated by the TREATY OF ROME, which involved only six of the OEEC members, and the move to full European currency convertibility. One response to the crisis was the DILLON ROUND of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT); another was a Euro-American summit in 1959 that called for a new transatlantic organization to be built on the structure of the old.

The OECD has expanded from its Atlantic origins to include other advanced economies that share a commitment to the principles of the market economy, pluralist democracy and respect for human rights. The twenty-nine members are Australia (1973), Austria, Belgium, Canada, the Czech Republic (1995), Denmark, Finland, France, Germany, Greece, Hungary (1996), Iceland, Ireland, Italy, Japan (1964), Korea (1996), Luxembourg, Mexico (1994), Netherlands, New Zealand (1973), Norway, Poland (1996), Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. Responsibility for general guidance and for management rests with the Council, which includes representatives of each member and the European Commission. The Council meets regularly on routine matters at the level of resident ambassadors and annually on political matters at the level of ministers – generally one or more of each member's ministers of foreign affairs, finance or trade. The Secretary-General presides over the Council, except at ministerial level, and sets its agenda. All bodies of the OECD work in English and French, and take

Organisation for Economic Co-operation and Development (OECD)

decisions only by consensus. National contributions to the budget (approximately US\$300 million) are based on a formula related to the size of each country and its economy. The United States is the biggest contributor (providing 25 per cent of the budget), followed by Japan.

The OECD is hard to define as an entity. Like the WORLD TRADE ORGANIZATION (WTO), it is an inter-governmental body that relies on strong participation of delegates from national governments at meetings of its 200 committees and working groups; like the INTERNATIONAL MONETARY FUND (IMF), it relies on the professional policy analysis and advice of the 2,000 members of the secretariat; like the INTERNATIONAL LABOUR ORGANIZATION (ILO), it consults closely with representatives of business and trade unions. The OECD is also the network of officials in capitals who produce the data for its 350 publications a year. If the entity is elusive, so is its influence. The most important thing that changes because of the OECD might be the thinking of the people – from technical officials to ministers – who attend its meetings or participate in its peer review process. The ideas it develops can have influence far beyond the organization – the ‘polluter pays’ principle, for example, was first developed there.

The OECD has no regulatory responsibility, no independent source of funds, no money to lend and no instruments within its control. Where GATT’s preamble speaks of a desire to enter into ‘reciprocal arrangements’, Article 1 of the OECD Convention says that the organization shall ‘promote policies’ designed to achieve the highest sustainable levels of economic growth and employment, and a rising standard of living in member-countries.

The OECD was an important macro-economic forum from its beginning. When the IMF proved not to be useful for managing the dollar problems of the 1960s, a restricted working party on ‘Policies for the Promotion of Better Payments Equilibrium’ was created. Known as WP3, members were senior economic officials of the GROUP OF 10 (G-10) or GENERAL AGREEMENT TO BORROW (GAB)

countries most affected by world trade and short-term capital movements. After 1971, reform of the IMF and the later creation of the GROUP OF 7 (G-7)/GROUP OF 8 (G-8) ECONOMIC SUMMIT, the OECD remained a political forum for consensus-building on issues of economic management. The annual ministerial meeting always precedes the summit, allowing more intensive analysis and preparation of the economic agenda. The inclusion of Russia in the G-8, which limits the time available for G-7 economic discussions, underlines the importance of the OECD.

The OECD has also been an important trade forum in which the major traders can assess the state of the system without having to hedge their analysis for fear of being tightly bound by their conclusions. The OECD helped prepare the ground for the 1982 GATT ministerial meeting and then for the URUGUAY ROUND, both on the new and strange idea of ‘trade in services’ and on the old problems of farm trade. Work at the OECD on conceptual problems was valuable because governments knew that negotiations over rules would take place in another forum.

Article 1 also provides that members will ‘contribute’ to sound economic expansion in non-member-countries in the process of economic development. Many OECD tasks require work on matters that affect members alone, but OECD is also a forum for coordinating action that members take with third countries. It facilitates burden-sharing and policy discussion between aid donors in the DEVELOPMENT ASSISTANCE COMMITTEE (DAC), which helps members reach a collective understanding of their abstract responsibility for assisting in the ‘development’ of others. DAC principles define the meaning of OFFICIAL DEVELOPMENT ASSISTANCE (ODA) through its list of country eligibility. Since the end of the Cold War, the OECD has become a forum for policy consultations with non-members (including the countries in transition) and leading developing countries in Asia and Latin America. Many non-member-countries now participate in the activities of OECD subsidiary bodies.

In Article 3, members agree (1) to furnish the organization with the information necessary for the accomplishment of its tasks; (2) to consult together on a continuing basis, and (3) to cooperate closely, taking coordinated action where appropriate. The closer an activity is to the beginning of this list, the more common it is at OECD. Consistent with the first two items, the development and sharing of standardized information is the fundamental activity. In any domain, a single country can conduct comparisons to itself through time, but OECD helps conduct rigorous comparisons to other similar countries at the same point in time. Next in importance is surveillance, sometimes called 'peer review'. It has been part of the process of sharing and evaluating information, of developing a common understanding of how the world works with a view to better policy-making and better policy-implementation. One of the particular strengths of the OECD is that this surveillance is carried out in all micro-economic domains, from trade to employment.

The third item, coordinated action, is relatively rare at OECD, although in certain areas its long association with the process of regional cooperation in Europe has made it a useful forum. Around 30 'decisions' which bind member-countries and more than 110 political commitments in the form of 'recommendations' are in effect today. They mainly concern two sectors: international economic LAW (notably in the 'Codes' on capital movements and investment) and the ENVIRONMENT. The OECD is useful as a decision forum to the extent that other forums and the substance of policy in an issue-area remain undeveloped. Once issues are well understood, it makes sense to move to a table that is equipped for distributive bargaining. The OECD contributes most by identifying norms and principles, or coordinating members' preparations, for negotiations that take place elsewhere.

The OECD structure reflects the organization of member-governments and the evolution of policy communities in various issue-areas. These committees (which usually meet twice a year) and their associated secretariat support

are broadly responsive to the demands of the relevant departments in capital cities. The annual meeting of the Council at ministerial level brings some coherence through a 'horizontal' work programme, responsive to policy directions as they are defined centrally in capitals.

In their 1998 communiqué (28 April 1998), ministers said that they had discussed:

key policy challenges of the globalising economy which they face in meeting the aspirations of their citizens – promoting economic growth and employment through sound macroeconomic policies and structural reform; the better integration of environmental, social and economic policies; and the strengthening of the multilateral system – thereby ensuring SUSTAINABLE DEVELOPMENT and a durable improvement in living standards. They focused also on the global implications of the financial and economic situation in Asia.

More specifically, they discussed issues on the agenda of the second ministerial conference of the WTO, and how to promote an open and well-informed public debate on trade and investment liberalization – a special priority after the hostile reaction of civil society organizations to the OECD's proposed MULTILATERAL AGREEMENT ON INVESTMENT (MAI). They also discussed the OECD 'jobs strategy'; a meeting of social policy ministers on ageing populations; the conclusions of a ministerial meeting on agricultural policy; corporate governance and regulatory reform; the OECD contribution to a forthcoming ministerial meeting on electronic commerce in such domains as trade policy, taxation, electronic authentication, consumer protection, privacy and security; measures to combat bribery, corruption and money laundering; and tax competition.

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ROBERT WOLFE

ORGANISATION FOR EUROPEAN ECONOMIC CO-OPERATION (OEEC)

see Organisation for Economic Co-operation and Development (OECD)

Organization of African Unity (OAU) Convention on Refugees

The Organization of African Unity's 1969 Convention on the Specific Aspects of Refugee Problems in Africa entered into force in June 1974. Forty-three African countries have become parties to it.

While this convention does not seek to replace the CONVENTION ON REFUGEES (1951) which is still recognized as constituting the 'universal and basic instrument relating to refugees', it does introduce some innovations meant to complement the legal framework of the 1951 convention. Noteworthy is the adoption of an enlarged definition of REFUGEES. Under the OAU convention, the term 'refugee' also applies to 'every person who, owing to external aggression, foreign domination or events seriously disturbing public order ... is compelled to leave his place of habitual residence' and to seek refuge abroad (Article 1,2).

See also:

migration, international; United Nations High Commissioner for Refugees (UNHCR)

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GUGLIELMO VERDIRAME

Organization of Arab Petroleum Exporting Countries (OAPEC)

Founded on 9 January 1968, the Organization of Arab Petroleum Exporting Countries (OAPEC) was predominantly a political organization that used economic means to achieve its ends. Its primary function was to use the politics of oil to influence the Arab Israeli conflict, thus differentiating it from the ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES (OPEC), which included many non-Arab states. The founding members – Kuwait, Libya and Saudi Arabia – were later joined by Iraq, Algeria, the United Arab Emirates, Qatar, Bahrain, Egypt and Syria (all, except the last three named, also members of OPEC). Drawing on the experience of the 1967 oil embargo, OAPEC ensured that decisions on any future action in support of the Arab cause would be taken only by those states whose economies would be directly affected by any cut in oil exports. It thus fulfilled a role that neither the Arab League nor OPEC could perform. It did not challenge the latter's predominant position in the implementation of general petroleum policy. Indeed, OPEC decisions on matters such as pricing were automatically binding on OAPEC members. OAPEC came to prominence at the time of the YOM KIPPUR WAR and subsequent 1973 oil crisis, when it (rather than OPEC) announced production cutbacks and selective embargoes. These were intended to adversely affect the Western supporters of Israel, particularly the United States, while

continuing to provide supplies for pro-Arab countries. Concurrently, OPEC decided to increase prices unilaterally. However, because so few commentators in the West were aware of the existence of OAPEC, it was generally assumed that both the embargo and the price increases were the work of OPEC.

Although OAPEC is best known for its political actions, it has also fulfilled economic and developmental functions by creating joint-venture companies and encouraging the training of key national personnel able to work within the petroleum and petrochemical industries, thus reducing dependence on multinational oil companies.

See also:

cartels

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FIONA VENN

Organization of Petroleum Exporting Countries (OPEC)

The Organization of Petroleum Exporting Countries (OPEC) seized control over the pricing and production levels of crude petroleum from the multinational oil companies in October 1973, the first successful exercise of power by raw material producers in the THIRD WORLD. Although its members see it as an international inter-governmental organization, it is also a powerful economic association that operates as a cartel (see CARTELS) and therefore experienced problems when it became necessary to allocate and enforce market quotas.

OPEC was formed in September 1960 by Venezuela and the main Middle Eastern oil

producers, in response to a company-imposed (and unnegotiated) cut of 15 per cent in host government revenues. Initially, the new organization had very little impact on the international oil industry, not least because the oil companies still insisted on dealing with each host government individually. Nonetheless, over the next decade OPEC increased its membership within the Middle East and in North Africa. By 1973, its original five members had increased to thirteen, all from the Third World. It also articulated a common position on matters of pricing control, conservation and host government participation in producing companies. Although OPEC has adopted some political goals (for example, supporting the cause of developing nations in the North-South dialogue), it has remained primarily an economic organization. This has allowed governments with very different ideologies to work alongside each other, including Iran and Iraq when the two countries were at war with one another.

Changing conditions in the oil industry meant that by 1970 host governments were in a stronger position relative to the oil companies, as evidenced by the 1971 TEHERAN AND TRIPOLI AGREEMENTS. By October 1973, OPEC was sufficiently strong to impose a unilateral price increase on the oil companies. In the same month, Egypt launched the YOM KIPPUR WAR, prompting the ORGANIZATION OF ARAB PETROLEUM EXPORTING COUNTRIES (OAPEC) to introduce production cutbacks and a selective embargo. These two actions resulted in a quadrupling of the price of oil within three months. By early 1974, OPEC members had imposed their power over the oil industry, with control over prices and production levels, and a majority interest in the producing companies.

During the 1970s, the power of OPEC was at its height. Many other developing countries hoped to follow OPEC's example, through cartels such as INTERGOVERNMENTAL COUNCIL OF COPPER EXPORTING COUNTRIES (CIPEC) and the INTERNATIONAL BAUXITE ASSOCIATION (IBA). However, the situation within the world oil industry began to change. New

Ottawa Imperial Conference

sources of production opened up in Alaska, the North Sea and Mexico, while conservation measures and economic recession reduced demand. By 1983, the real price of oil began to fall and, instead of setting prices, OPEC was forced to allocate production quotas, which were often ignored by its members. In this situation, both the power of OPEC and its solidarity began to weaken. However, it remains the case that a substantial proportion of the world's proven oil reserves are controlled by OPEC members.

See also:

cartels. commodity; international organizations (IOs); New International Economic Order (NIEO); petrodollars

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FIONA VENN

Ottawa Imperial Conference

The Ottawa Imperial Conference of 1932 was an attempt by the British Empire to counter the growing economic nationalism unleashed by the US Smoot–Hawley Act of 1929 and the Great Depression of the early 1930s (see EMPIRE, BRITISH; GREAT DEPRESSION; SMOOT–HAWLEY TARIFF). After the defeat of the largely free-trading British Labour government in 1931, those (mainly in the Conservative party) who had long advocated ‘safeguarding’ or ‘tariff reform’ pushed for some sort of IMPERIAL PREFERENCE scheme to protect imperial employment and export markets from predatory pricing. The main instigator of the Ottawa Conference was Prime Minister R.B. Bennett of Canada. The conference led to an Empire-wide tariff wall being erected, which significantly increased trade tensions worldwide. It has been condemned as

a ‘muddle ... its Agreements were the results of *ad hoc* concessions and last-minute bargaining’ (Drummond, 1974: 31). It was effectively shelved with the Lend-Lease Act of 1941 between Britain and the United States (see LEND-LEASE), and its provisions unwound in the rounds held in the 1950s of the GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT).

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ANDREW WILLIAMS

overload theory

‘Overload theory’ was developed in the mid-1970s as an attempt to provide an explanation for the conditions of FISCAL CRISIS and political overload in a number of developed states. Public expenditure was growing faster than GROSS NATIONAL PRODUCT (GNP), to the point where it caused a decline in private consumption (fiscal overload); simultaneously, governments – unable to keep political conflict within the normal channels of representative government – faced a serious erosion of public confidence in their regimes (political overload). Overload theory addresses this situation – in which rapid growth of the electorate’s expectations of government leads to inevitable disappointment and a subsequent decline in public confidence, undermining the government and its ability to govern – and argues towards a reduction in dependency on the public sector as its solution. Perhaps because of this, the overload thesis has proven exceptionally durable, despite its limited focus on the political and economic conditions of the 1970s: virtually every government in Western Europe, irrespective of party affiliation, is engaged in a process of attempting to reduce the electorate’s expectations of government and to reduce the proportion of national income devoted to public services.

Overload thus occurred against the backdrop of unprecedented parallel rises in un-

employment and inflation (see STAGFLATION) and a resultant decline in the ability of government to deliver on expenditure pledges. Theorists of a neo-conservative or liberal market persuasion argued that the evolution of stagflation marked an inevitable failure of KEYNESIAN ECONOMICS: the pursuit of full employment came at a price, in the form of higher inflation. Overload theorists sought to provide an explanation for the onset of stagflation and to account for the decline in effective government, together with the increasing alienation of the public and pressure groups from the government's objectives.

Fundamental among these explanations was what Samuel Brittan termed the 'economic contradictions of democracy' (Brittan, 1975). In the pursuit of power in each electoral cycle, political parties pledge expanded public services and explicitly politicize the role of state enterprises, resulting in an increase in the expectations of both the electorate and a wide variety of interest groups, and thus their dependency on government programmes. Consequently, the popular perception emerges that political problems can (and should) be solved by government. This has changed the very nature (and expectations) of the role of government:

Once upon a time, then, man looked to God to order the world. Then he looked to the market. Now he looks to the government.

(King, 1975)

However, the 'economic contradictions of democracy' mean that government dependency will almost inevitably lead to the disappointment and alienation of those reliant on its services. For example, the livelihood of workers within state-owned enterprises competing for government contracts is directly affected by government policies; such workers' expectations of the potential benefits from government are increased and then (inevitably for many) disappointed. Unfulfilled expectations and growing alienation also affect a wide variety of pressure groups who are engaged in conflict over government programmes which are perceived as failing to deliver.

This decline in governing capacity is caused by the over-concentration of power in a limited number of executive agencies, overwhelming the decision-making machinery of government. This is not due either to the failures of political leaders or to problems of institutional design, but is caused by the increasing complexity of decision-making and the inability of government to secure reliable delivery of service from its agents. As economies grow, they gain in complexity, leading to an increase in the number of dependency relationships confronting government. Increase in the reliance of governmental actors on the cooperation of external agents is coupled, under conditions of overload, with an increase in the likelihood of non-compliance by the agents on whom government is dependent. Governments' failure to deliver on economic management and electoral expectations increases incidences of non-compliance, further eroding the capacity of government to fulfil expectations, thereby enhancing perceptions of overload and declining governing competence.

Government is caught in a 'Catch-22' situation: unwilling to lower public expenditure (as to do so will reduce the legitimacy of government) but forced to do so (as otherwise it will constantly fail to deliver on its programmes). As social expenditure grows, it undermines the process of private and capital accumulation, resulting in inflationary wage demands which push up prices, leading to greater social demands, a decline in saving and a subsequent decline in state capacity and confidence. The focus of overload theory is not the rise of dependency *per se*, but the linking of this to increased public expectations of delivery of services by the government.

The problem of overload can be tackled either by lowering the demands which are placed on the decision-making processes of government (lowering expectations) or by reducing the propensity of government to fail in the delivery of its services (lowering the dependency of government on 'arm's length' agents). Initially, overload theorists argued that, while in theory progress could be made by tackling either the demand or dependency

aspects of overload, in practice the latter was not susceptible to reform, as dependency relations will continue to increase in the future with the progressive rise in the complexity of social problems likely to continue unabated.

It is only on the demand side that moves to lessen ungovernability can thus be achieved: by reducing the load. However, this strategy relies on an almost impossible reduction of public expectations and a reversal of the trends towards an ever more complex organization of society.

One practical solution is to devolve a number of routine, typically administrative elements of decision-making to semi-autonomous agents, either territorially or functionally, returning central government to its initial role as the generator of the legal framework of economic activity and lessening its role as the provider of basic services, welfare and capital investment. Thus, ministers remain responsible for managing policy, with day-to-day operations handled by the responsible agent.

An alternative solution to the problems of demand overload is to reduce the aspirations of those seeking benefits from government. However, overload theorists are far from confident of voluntary restraint by actors. They cite (1) a lack of realism in a public whose expectations have risen in response to electoral competition; (2) the influence of a powerful lobby for increased state activity, constituted by state bureaucrats and officials with a professional commitment to improve the scope of service provision, and (3) the central strategic role of the agents on whom government is dependent for the delivery of its programmes in both the political and economic sphere – agents whose members' interests often undermine governmental autonomy in MACRO-ECONOMIC POLICY (in particular, the control of INFLATION and the delivery of services).

This in-built pessimism within overload theory points to the need for state actors to remove 'unreasonable demands from government'. Overload theory has thus been adopted by neo-conservatives as a rationale for legislative activism by governments of all persuasions in weakening the role of TRADE UNIONS,

promoting the notion of self-reliance to the electorate, instigating welfare cuts and undertaking a far-reaching programme of PRIVATIZATION – including the replacement of bureaucrats with regulated commercial managers.

Thus – though of limited predictive value as a theory, born as it is out of the particular circumstances of the early 1970s – the overload thesis has endured to dominate the ideological debate over the role of government and the dependency of the electorate.

See also:

bureaucracy; corporatism; legitimacy crisis; political business cycle; 'Reaganomics'; state, the; welfare state

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describes the difficulties of lessening the burden of government in advanced capitalist states due to the growing incidence of structural dependency on the welfare state by citizens.

NICK ROBINSON

overproduction

'Overproduction' has two meanings in Marxian crisis theory. In broad terms, it expresses the inability to sell the output and realize the (surplus) value produced. This definition is not very useful except as part of an argument against SAY'S LAW, or as a pointer to further theoretical development (as in the crisis theories of Engels, Kautsky, Otto Bauer and, more recently, Armstrong, Glyn and Harrison). Overproduction can more usefully be analysed as one aspect of crisis, alongside UNDERCONSUMPTION, DISPROPORTIONALITY and the FALLING RATE OF PROFIT (FRP). Each of these aspects of Marx's crisis theory is related to a distinct set of relationships within capitalist (re)production and each of them has given rise to an extensive literature; however, in isolation these theories have achieved only limited success.

Production develops under capitalism on the basis of competition in each branch of industry. Within each production unit, machinery is continually introduced in order to increase the potential productivity of labour and managers continually press the workforce to increase output and reduce unit costs (what Marx called 'the extraction of relative and absolute SURPLUS VALUE'). As a result, fixed capital and raw and processed materials tend to increase relative to living labour. This type of competition creates a tendency towards the UNEVEN DEVELOPMENT of branches and overproduction within them. In certain circumstances, these processes may trigger a general crisis, in which case overproduction, disproportionality and underconsumption co-exist with a decline in the general rate of profit. In this relatively complex context, overproduction

not only indicates the limited size of the market for consumption (or investment) goods, it also reflects other determinants of the trajectory of the economy – especially the tendential rise of the organic (though not necessarily the value) composition of capital, the (conflict-ridden) process of determination of the value of labour power and wages, the role of the financial system and the STATE, and so on. In order to explain specific crises, they must be analysed in context.

Further reading

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ALFREDO SAAD-FILHO

overstretch theory

Overstretch theory claims that global hegemons and great powers expand their geographic reach and global commitments so far that they eventually sap their resources and become unable to sustain their influence, leading to collapse from within or defeat by rising challengers.

This notion was discussed by Paul Kennedy in his book, *The Rise and Fall of the Great Powers* (1988). Kennedy describes cycles of rising and falling hegemonic power through history and implies that the United States will, like so many hegemons before it, experience inevitable decline. Kennedy's ideas were debated in scholarly and policy circles in the United States, which was at the time experiencing a moderate economic recession and worried about economic challenges from Europe and Japan. Kennedy said that the rise and fall of great powers (particularly Spain, the Netherlands, Britain and the United States) has correlated over the long term with their productive and revenue-raising capabilities on

one hand and their military strength on the other.

According to Kennedy, the strength of the world's most powerful states relative to one another is constantly changing, primarily because each experiences different rates of ECONOMIC GROWTH and because technological achievements bring them varying advantages. For example, development of the long-range gunned sailing ship and ocean commerce starting in the fifteenth century did not benefit European states equally; some states benefited more than others. Similarly, the development of steam power was of more advantage to some states than others: but once their productive capacity benefited from such developments, states normally found the building and maintenance of large militaries to be more manageable. In short, wealth is necessary to sustain military power, and military power is crucial to the acquisition and protection of wealth. However, if the proportion of a state's resources devoted to military purposes – and thereby diverted from further wealth creation – grows too large, the power of the state inevitably weakens over time. Similarly, if a state over-extends itself by taking large territories abroad or by engaging in costly wars,

it runs the risk that the potential benefits from external expansion may be outweighed by the great expense of it all – a dilemma which becomes acute if the nation concerned has entered a period of relative economic decline.

(Kennedy, 1988: xvi)

Kennedy also wrote that:

economic prosperity does not *always and immediately* translate into military effectiveness, for that depends upon many factors, from geography and national morale to generalship and tactical competence.

(ibid.)

Nevertheless, he said,

the fact remains that all of the major shifts in the world's *military-power* balances have followed alterations in the *productive* bal-

ances; and further, that the rising and falling of the various empires and states in the international system has been confirmed by the outcomes of the major Great Power wars, where victory has always gone to the side with the greatest material resources.

(ibid.: 567)

The process whereby differential technological advancements and economic growth influenced global political and military balances obtained in the second half of the twentieth century just like in previous historical periods. This was manifested acutely by the military and political blocs of the United States and the Soviet Union, and the arms race between those two countries from the 1950s to the 1980s. But, in a hardly veiled warning to the United States, Kennedy pointed out that the superpowers' share of global product (and their growth rates) were declining, with Europe, Japan, China and the rest of the developing world moving in the opposite direction.

The fall of the Soviet Union, which came shortly after Kennedy's book appeared, was a contemporary manifestation of his ideas. The Russians had extended their empire throughout the Soviet Union, to Central and Eastern Europe, and much farther abroad to substantial portions of the developing world. Furthermore, they were spending well in excess of 10 per cent of their economic output on unproductive military expenditure – twice the expenditure of their main competitor, the United States. This military, political and economic empire, while having its advantages for Moscow, became increasingly costly. The Soviet Union itself, beset by failing economic policies, was costly to hold together. But bearing this burden may have seemed quite reasonable when viewed alongside Moscow's subsidization of economies in Central Europe and the developing world (for example, North Korea and Cuba), and the expensive wars fought or supported in Africa, Asia and Central America. Soviet President Mikhail Gorbachev recognized, on his advent in 1985, that the survival of the Soviet Union depended on retrenchment – and recognized that the notion

of imperial overstretch applied to the Soviet Empire. He withdrew support from developing countries and let the Eastern Europeans go their own way. He was more forthcoming with the United States on arms control and ended Soviet involvement in Afghanistan. But Gorbachev failed to act swiftly enough with his policies of economic restructuring (see *PERESTROIKA*) and he underestimated the extent to which his policy of political openness (*glasnost*) would unleash nationalist sentiments within the Soviet Union. By the end of 1991, the Soviet Union disintegrated into fifteen separate states.

The rise and decline of power, and the theory of imperial overstretch, might also apply to the current superpower. Although the United States is, at present, still in a class of its own economically and perhaps even militarily, it cannot avoid confronting the two great tests which challenge the longevity of every major power that occupies the pre-eminent position in international affairs: whether it can preserve a reasonable balance between the nation's perceived defence requirements and the means by which it maintains those commitments, and whether 'it can preserve the technological and economic bases of its power from relative erosion in the face of ever-shifting patterns of global production' (ibid.: 665).

Kennedy later argued that the US victory in the GULF WAR should not be taken as *prima facie* evidence of continued hegemony. His theory of imperial overstretch shows that a great power, in order to stay great, needs more than a large military. It also needs a strong economy and healthy society to sustain its military strength in the long term.

A response to Kennedy was promptly found in Joseph Nye's *Bound to Lead* (1990). Nye suggested that a hegemon – and particularly the United States – could overcome Kennedy's arguments if it is careful in its use of power and is able to demonstrate to other states that their interests can be advanced by following the hegemon's lead. This would partly explain, for example, the success of the United States in building a global free market economy based

on its conception of what is best for Americans and their allies.

However, defying the overstretch theory will not be easy for the United States and other great powers. Kennedy argued that:

The feat demanded of most if not all governing bodies as the world heads toward the twenty-first century is ... a *threefold* one: simultaneously to provide military security (or some viable alternative security) for its national interests, *and* to satisfy the socioeconomic needs of its citizenry, *and* to ensure sustained growth, this last being essential both for the positive purposes of affording the required guns and butter at the present, and for the negative purpose of avoiding a relative economic decline which could hurt the people's military and economic security in the future.

(Kennedy, 1988: 575)

The United States and would-be great powers might do well to heed Kennedy's none-too-subtle warning: 'The history of the rise and fall of the Great Powers has in no way come to a full stop' (ibid.: xxiii).

See also:

hegemonic decline; hegemonic transition; hegemony; imperial rivalry; imperialism; long cycles; war cycles

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PAUL G. HARRIS

Owen, Robert (1771–1858)

Robert Owen, the founder of British SOCIALISM, was born at Newtown, Montgomeryshire. He was the son of Robert Owen, a saddler and ironmonger, as well as the local postmaster, and Anne née Williams, a farmer's daughter. As a youth, he was intellectually precocious – reading voraciously, if unsystematically. At the age of ten, a religious crisis led to a loss of faith; he would later be widely associated with religious scepticism. In 1781, Owen was apprenticed to a Stamford cloth merchant, James McGuffog, and three years later he joined a London retail firm. Moving to Manchester, he borrowed £100 from his brother William and entered a partnership constructing 'mules' for making thread. Soon the firm of Jones and Owen had forty employees. In 1792, Owen agreed to manage a cotton mill with 500 employees owned by Peter Drinkwater, who had first applied the Bolton and Watt engine to cotton-spinning in Manchester. Evidencing great talent in both managerial and technical innovation, Owen acquired (with other partners) the New Lanark mill south of Glasgow. It was owned by David Dale, whose daughter Owen had married the previous year; Owen moved there as manager on 1 January 1800. When Dale died in 1806, Owen formed a new partnership. His profits (about 40 per cent of the total) were considerable; the growth in profits averaged some 12.5 per cent annually.

Owen at New Lanark

Owen rapidly became known as one of the great self-made capitalists of the nineteenth century, as the quality of his cotton thread rapidly outstripped that of his competitors. He regarded New Lanark, however, as a philanthropic experiment from the outset. Though not yet a 'socialist' (the term would not be coined until the mid-1820s) and advocating neither profit-sharing nor the elimination of 'competition' at the mill or within the cotton trade, Owen nonetheless sought resolutely to improve both working and living conditions for his labourers. About 1,800 people were initially employed at the mill, including some 500 pauper children. In 1816, Owen reduced their working day from eleven-and-three-quarter hours to ten-and-three-quarter hours. He replaced shoddy and expensive goods in the company store with better goods sold at wholesale prices. He gave much attention to infant and juvenile education, opening the Institute for the Formation of Character in 1816, where dancing, singing and other lessons were taught. Here his chief theme was the exclusion of punishment from the educational process and teaching by encouragement, activity and example, based on the interest of the pupil, rather than rote learning. In the workplace, he installed 'silent monitors' – coloured blocks of wood rotated above each labourer's workplace, whose different coloured sides reflected the achievements of each worker, from black denoting poor performance to white denoting excellence. Employees with illegitimate children were fined. Pilfering and absenteeism were reduced. One-sixtieth of wages was set aside for sickness, injury and old age. Resistance to these schemes was finally broken when, in 1806, Owen continued to pay full wages during an US cotton embargo in 1806. By 1816, New Lanark (often termed 'the happy valley') was renowned throughout Europe and was deluged with visitors (over 20,000 between 1815–25) curious to see how Owen had combined high profits with philanthropy. Owen, however, could not rest satisfied; moreover, he met increasing resistance from his

partners. In 1813, avoiding a hostile takeover effort on their part, Owen secretly raised enough capital to outbid his partners at a public auction of New Lanark. He now formed a new partnership composed of the Baptist physician and philanthropist, Joseph Fox; a former fishmonger and future Lord Mayor of London, Michael Gibbs; three Quakers, William Allen, Joseph Foster and John Walker; and the philosopher, Jeremy Bentham, for whom it was a rare profitable venture.

The development of Owen's thought

In *A New View of Society; or, Essays on the Principle of the Formation of the Human Character* (1813-4), which remains his best-known work, Owen demanded a system of national education to prevent idleness, poverty and crime among the 'lower orders', and recommended restricting 'gin shops and pot houses', the state lottery and gambling, as well as penal reform, ending the monopolistic position of the Church of England, and collecting statistics on the value and demand for labour throughout the country. Owen denied proposing 'that the British government should now give direct employment to all its working population'. Instead, education should lead the poor 'to find employment sufficient to support themselves, except in cases of great sudden depression in the demand for, and consequent depreciation in the value of, labour' (Claeys, 1993: vol. 1, p. 97). To ensure the primacy of private enterprise, public labour on roads, docks and shipbuilding would be paid less than the average local wage. Aiming now to solve the problem of poverty at the national level, Owen in 1816 announced that 'the chief object' of his existence would be to make 'universal' the results of his experiments with the character of the labouring classes. Crucially, he now also insisted that the new manufacturing process be 'gradually diminished' and that Britain aim for greater self-sufficiency in food. In *Observations on the Effects of the Manufacturing System* (1815), Owen identified for the first time 'immediate pecuniary gain, to which on the great scale

every other [principle] is made to give way' as the 'governing principle of trade, manufactures, and commerce'. 'Buying cheap and selling dear', the 'spirit of competition', which had made Owen rich, were now vilified as the moral cause of the excesses of industrialization. In 1817, he proposed that 'villages of union' of 500-1,500 people united by 'mutual and combined interest', would be situated in the countryside, but would have some machinery of their own. With parliament's failure to pass further factory bills came a hardening of Owen's views. The rest of his life would be devoted to the creation of cooperative communities. Much of his own fortune was dissipated in acquiring the New Harmony, Indiana, colony from the Rappites. With its failure, Owen returned to Britain, assisting in the founding of labour exchanges in the early 1830s, in efforts to form a general union of all trades and in the attempt to create a large-scale Owenite community at Queenwood, Hampshire, which finally collapsed in 1845.

The Owenite legacy in political economy

Owen's *Report to the County of Lanark* (1821) was his first major statement of hostility to the principle of individual competition and the existing system of money and exchange. Here, Owen first proposed the use of 'labour notes' instead of gold and silver, as a system of rewarding labour that was both more secure and more just. This system was later widely identified with John Ruskin, especially as described in *Unto This Last* (1863). The cooperative system identified with the Rochdale Pioneers after 1845 did not seek to rehouse workers in communities, but to share profits among labourers. This gradualist ideal became increasingly attractive to socialists after 1880 and, after a hiatus of some thirty years, Owenite economics were perceived to be increasingly attractive by Fabians such as Frank Podmore (Owen's most important biographer), as well as liberal economists sympathetic to cooperative aims (such as JOHN STUART MILL and Henry Fawcett) and more

Owen, Robert

revolutionary socialists (like William Morris and H.M. Hyndman).

Reference and further reading

Owen's main writings have been reprinted as Gregory Claeys (ed.) *Selected Works of Robert Owen* (London: Pickering & Chatto, 1993), which includes (vol. 4) an annotated edition of Owen's *Life*. His chief early works are reprinted in his *Life*, vol. 1A (1858). His complete works comprise at least 160 titles, many of which are

brief addresses. He also edited and contributed to many periodicals; a relatively complete bibliography is given in John Harrison's *Robert Owen and the Owenites* (London: Routledge & Kegan Paul, 1969). The main study of Owen's economic ideas and their influence is Claeys' *Machinery, Money and the Millennium: From Moral Economy to Socialism, 1815–1860* (Princeton, NJ: Princeton University Press, 1987).

GREGORY CLAEYS